An exploration of the usefulness of the disclosures for derivatives in company annual reports

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Keywords

Derivatives; disclosure; IASB; IFRS 7; influence; lenders; lobbying; risk; users; standard-setting

Abstract

Responding to mixed evidence regarding the decision-usefulness of annual report disclosures for derivative financial instruments to capital market participants and concerns identified by practice, the objective of this thesis is to explore whether the derivatives disclosures required under international accounting standards provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons. User perceptions of usefulness were examined through two qualitative studies.

The first study comprised interviews with credit-side analysts. The aim of the first study was the same as the overarching research objective. The first study revealed companies' disclosures were decision-useful to some extent. However, failure to reflect actual use of derivatives throughout the period and the inability of users to understand companies' risk management practices and off-balance sheet risk from information considered generic and boilerplate, were limitations.

The second study analysed IFRS 7 Financial Instruments: Disclosures (IFRS 7) and related documents over a ten-year period from 2004 to 2014. The aim of the second study was to explore usefulness from the perspective of the design of IFRS 7, including the extent to which the IASB has incorporated users' views into the standard over time. The second study revealed that the design of IFRS 7 has evolved to suit the economic interests of audit firms. However, in the second study, where users expressed a desire for improved information about risk management practices and off-balance sheet risk, audit firms supported them. The resistance of companies to disclosing risk management practices and off-balance sheet risk, combined with the reluctance of the International Accounting Standards Board (IASB) to mandate disclosures that may cause companies to incur proprietary costs, were identified as the main obstacles to decision-usefulness.

The results of the first study complement and extend existing archival and survey research, and increase knowledge about the informational requirements of lenders, an important class of financial statement user. The results support the IASB's disclosure recommendations in its exposure draft, the Conceptual Framework for Financial Reporting (IASB, 2015d), but at the same time, highlight that for these proposed measures to be successful in relation to IFRS 7, the IASB may need to address other issues.

The results of the second study provide new evidence about the disclosure preferences of stakeholders to the standard setting process and the types of arguments most likely to influence the IASB. Where earlier research identified a pluralistic standard setting process influenced by preparers, this research shows that a different pattern emerges over a longer period. The research findings across both studies highlight to the IASB that the disclosure of risk management practices and off-balance sheet risk exposure is strongly demanded by users and resisted by companies.

The limitations of this research include the small sample of interviewees from one category of user, analysis of a single disclosure standard, and limited generalisability. However, these were compensated for in part by the expertise of the interviewees and the economic importance of the disclosure standard, IFRS 7. Future research could extend this study to other accounting standards, examine the disclosure preferences of stakeholder groups in more depth, and explore how the IASB makes its cost/benefit evaluations, particularly for proprietary costs.

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List of Abbreviations

AASB	Australian Accounting Standards Board
AICPA	American Institute of Certified Public Accountants
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
BIS	Bank of International Settlements, Basel, Switzerland
Conceptual Framework	The Conceptual Framework for Financial Reporting
ED	Exposure draft
ED7	ED7 Financial Instruments: Disclosures
ED/2008/10	ED/2008/10 Improving Disclosures about Financial Instruments
ED/2009/3	ED/2009/3 Derecognition
ED/2010/13	ED/2010/13 Hedge Accounting
EFRAG	European Financial Reporting Advisory Group
EU	European Union
FASB	Financial Accounting Standards Board
FSB	Financial Stability Board
G20	Group of 20 nations
IAS	International Accounting Standard
IAS 25	IAS 25 Accounting for investments
IAS 30	IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions
IAS 32	IAS 32 Financial Instruments: Disclosure and Presentation
IAS 39	IAS 39 Financial Instruments: Recognition and Measurement
IASB	International Accounting Standards Board

IASC	International Accounting Standards Committee
IFRS	International Financial Reporting Standard
IFRS 7	IFRS 7 Financial Instruments: Disclosures
IFRS 9	IFRS 9 Financial Instruments
IFRS 13	IFRS 13 Fair Value Measurement
IOSCO	The International Organization of Securities Commissions
MD&A	Management discussion and analysis
OFR	Operating and financial review
US	United States of America
USGAAP	Unites States Generally Accepted Accounting Principles
VaR	Value at Risk model

Glossary

Big 4	Largest global professional services firms: PWC, KPMG, Deloitte, EY.
Buy-side analyst	See fund managers.
Business risk	Any risk that may affect company profit.
Cash flow hedge	A hedge of the exposure to variability in cash flows attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecast transaction.
Credit risk	The risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.
Credit-side analyst	Banks and other financial institutions employ analysts to provide independent credit analysis on the companies and industries to which the bank has exposure.
Currency risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rates.
Decision-usefulness	The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity.
Derivative	A derivative is a contract with a value that is dependent upon, or derived from, one or more underlying variables (e.g. interest rate or foreign exchange rate), rather than its nominal value.
Equities	Issued share capital of public companies traded on equities markets
Equity research	Production of forecast information by sell-side analysts, primarily cashflow and profit based measures, and management strategy to support buy/sell/hold recommendations and reports on equities.
Fair value hedge	A hedge of the exposure to changes in fair value of a recognised asset or liability or unrecognised firm commitment.
Financial risk	Risk associated with financial assets and liabilities.
Front-end	Annual report sections devoted to mandatory and voluntary disclosure narrative, prior to statutory reporting sections, typically starting with the directors’ report.
Fund managers	Individuals within investment companies, assurance, and pension funds responsible for asset selection and allocation decisions. Also referred to as buy-side analysts, some funds conduct their own

research but many are consumers of sell-side analyst reports.

Futures contract	A futures contract is a derivative in which counterparties agree to buy or sell an asset for a price agreed upon today (the future price) with delivery and payment occurring at a future point, the delivery date.
Hedge	See fair value hedge and cash flow hedge.
Hedged item	An asset, liability, firm commitment, highly probable forecast transaction, or net investment in a foreign operation that exposes a company to risk of changes in fair values or future cash-flows.
Hedging instrument	A designated financial instrument, often a derivative, whose fair value or related cash flows should offset changes in the fair value or cash flows of a designated hedged item.
Hedged rate	The combined or 'effective rate' of the underlying variable (e.g. interest rate) of the hedged item and the hedging instrument.
Interest rate risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates.
Liquidity risk	The risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value.
Mandatory disclosure	Reporting compliant with relevant reporting standards and regulatory/legislative requirements.
Market risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices, comprises currency risk, interest rate risk, and other price risk.
Option	An option is a derivative in which counterparties agree that the purchaser of the option has the right to buy or sell a particular asset at a later date at an agreed upon price.
Other price risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices other than those arising from interest rate risk or currency risk, whether those changes are caused by factors specific to the individual financial instrument or its issuer, or by factors affecting all similar financial instruments traded in the market.
Recognition and measurement	Transactions are recognised in the primary financial statements and measured in accordance with the requirements of applicable accounting standards.
Risk reporting	Voluntary and mandatory reporting by companies of business and financial risks and their management of those risks.

Sell-side analyst	Producers of equities research and forecasting data for consumption by fund managers and other buy-side participants.
Sophisticated user	Users of financial information are either sophisticated (expert) users or private investors. Sophisticated users are investment analysts (sell-side), fund managers (buy-side), and corporate lenders (credit-side).
Speculation	Investment in stocks, property, derivatives, or other ventures in the hope of gain but with the risk of loss. Derivatives not held for hedging purposes are held for speculation (also referred to as 'held for trading').
Swap	A derivative in which counterparties exchange specific cash flows of one party's financial instrument for those of the other party's financial instrument. Common swaps include interest rate and foreign currency swaps.
Voluntary disclosure	Information provided by companies within annual reports not required by statutory reporting requirements.

Statement of Original Authorship

The work contained in this thesis has not been previously submitted to meet requirements for an award at this or any other higher education institution. To the best of my knowledge and belief, the thesis contains no material previously published or written by any other person except where due reference is made.

QUT Verified Signature

Signature:

Date: 23|5|16

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CHAPTER 1 INTRODUCTION

1.1 Background

Despite the prevalence and importance of derivative financial instruments and their regular association with financial scandals, it is notoriously difficult for companies to summarise risk management practices, end of period balances, and within period performance relating to derivatives and related transactions in a succinct and understandable way (Chalmers & Godfrey, 2000; Ernst & Young, 2008; Papa & Peters, 2011, 2013; Roulstone, 1999; Woods & Marginson, 2004). That companies achieve transparency in their disclosure of derivatives is, however, extremely important, “because no single number, regardless of the measurement attribute used, provides all the information users need to understand financial instruments” (IASB, 2008b para.BD19). This thesis examines the decision-usefulness of the disclosures for derivative financial instruments.

1.2 Motivation

While derivatives serve a useful and practical risk management function in business, there has been significant growth in the development of new types of derivatives since the mid-1970s, and some believe that the accounting standard setters have not kept pace with these changes (Camfferman & Zeff, 2007). This was particularly evident during the 1980s, as rapid financial innovation led to new and exotic instruments engineered around the basic building blocks of swaps, options, and futures contracts (Camfferman & Zeff, 2007). It was similarly the case during the 2007/8 financial crisis, when banks structured transactions to ensure derivatives remained off balance-sheet and largely undisclosed (Jones, 2011).

Ongoing issues with accounting for derivatives have resulted in the International Accounting Standards Board (IASB) working on projects for the recognition, measurement, and disclosure of these often complex instruments for most of the past twenty-five years (IASB, 2008b). This has resulted in standards being issued, amended, replaced, and further amended. The first disclosure standard, IAS 32 Financial Instruments: Presentation and Disclosure (IAS 32) was issued in 1995 and replaced in 2005 with the acknowledgement that "techniques used by entities for measuring and managing exposure to risks arising from financial instruments have evolved and new risk management concepts and approaches have gained acceptance" (IASB, 2005 para.IN1). Accordingly, IAS 32s replacement, IFRS 7 Financial Instruments: Disclosures (IFRS 7), increased the requirements for companies to provide information about their exposure to the risks associated with recognised amounts, why management enter into those risks, and how they are managed (IASB, 2005). Since its issue, the IASB have substantively amended IFRS 7 three times for disclosures applicable to derivatives: twice in response to deficiencies identified during the 2007/8 financial crisis, and once following a comprehensive review of hedge accounting.

An increased volume of disclosures applicable to derivatives under IFRS 7 has coincided with increased concern from regulators and the accounting profession that financial statement disclosures are growing in length while decreasing in informativeness (ACCA, 2012; FRC, 2009, 2011; Hoogervorst, 2013; IASB, 2008a, 2008b; KPMG, 2011). In their 2015 exposure draft, the Conceptual Framework for Financial Reporting (Conceptual Framework) the IASB called upon companies to focus more on entity specific information and avoid "boilerplate" disclosures (IASB, 2015d para.7.18). For IFRS 7, practitioner research has highlighted that poor quality disclosure by companies is an ongoing issue (Ernst & Young, 2008; Papa & Peters, 2011, 2013).

Against the background of financial engineering, new disclosure requirements, and poor disclosure quality, a lack of transparency regarding companies' use of derivatives has been a factor in accounting scandals for many years. Most notably, during 2007/8, uncertainty regarding banks' exposures to asset securitisations and credit default swaps brought inter-bank lending to a virtual halt (Barth & Landsman, 2010). More recently, the JP Morgan Chase 'London Whale' trading scandal of 2012 cost the company $6.2 billion, while the CEO dismissed the matter as a "tempest in a teapot" and claimed that highly complex transactions using synthetic derivatives were "economic hedges" (US Senate, 2013, p. 1).

Companies outside of the financial services sector also make use of derivatives (Chalmers & Godfrey, 2000; Gebhardt, 2012; Heaney & Winata, 2005; Nguyen & Faff, 2002) and losses can be significant. Two Australian examples of corporate failure linked to derivatives and poor disclosure were the mining companies Sons of Gwalia Ltd and Croesus Mining Ltd, where potentially important information relating to risks around hedge restructuring were not fully disclosed to stakeholders (Taylor, Tower, & Neilson, 2010). It was further claimed that during the 2007/8 financial crisis, non-financial companies in emerging economies lost billions of dollars through their use of a popular currency derivative, ostensibly held for the purpose of hedging risk on import and export transactions (Dodd, 2009; Zeidan & Rodrigues, 2012). The Bank for International Settlements (BIS) in Basel, Switzerland, has warned that conditions and the use of structured derivative products may once again be aligning for a similar event in some Asian economies (BIS, 2014).

That hedging and lack of transparency is implicated in so many of the scandals involving derivatives is particularly relevant at present, as there is a new standard for the recognition and measurement of financial instruments. As companies adopt IFRS 9 Financial Instruments (IFRS 9), they will be subject to less restriction on obtaining favourable hedge accounting treatment. This will increase the need for high quality disclosures to avoid situations where hedging is used by companies to camouflage speculation.

Despite the strong economic basis for derivatives disclosures and concerns identified by practitioners, academic research into the usefulness of derivatives disclosure has been limited. Some conclusions about decision-usefulness can be inferred from archival research, such as Ryan (2012), who found a less than expected degree of value-relevance or risk-relevance for derivatives disclosures. However, archival research does not usually provide insight into the reasons underlying its results. Other limitations of existing archival research include its emphasis upon the quantitative disclosure requirements of IFRS 7 and the focus upon the banking sector. More broadly, archival research is unable to determine whether financial statements are the source of information used by the market, or whether other undisclosed information might have been more useful. Similarly, recent survey evidence from Johansen and Plenborg (2013) identified high user demand for financial instruments disclosure coupled with comparatively low user satisfaction and pointed to a need for more research into why satisfaction is low, or how satisfaction could be increased. This thesis addresses these areas of limitation.

This research takes a user perspective of disclosure. To the extent that archival research addresses aspects of the decision-usefulness construct (Barth, Beaver, & Landsman, 2001) it reflects the perceptions of the market taken as a whole. Users are defined in the Conceptual Framework as “existing and potential investors, lenders and other creditors” (IASB, 2010a para.OB2). They are the individual capital markets participants that provide finance to an enterprise. This distinction is non-trivial, given that for the IASB the objective of financial reporting is to provide users with financial information that will assist them to make "decisions about providing resources to the entity" (IASB, 2010a para.OB2). This is the decision-usefulness objective of financial reporting.

1.3 Objective

Motivation for this research arose from observation of scandals related to derivative financial instruments, reactive changes to mandatory disclosures by the standard setter, and concern from practitioners and academics that companies comply with the requirements of IFRS 7 in a 'boilerplate' manner. This led to the research objective: to explore whether the derivatives disclosures required by IFRS 7 provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons.

1.4 Research Questions

The research objective required the identification of possible reasons why information provided pursuant to IFRS 7 may not be decision-useful. These reasons were identified through a review of existing literature, and gaps in the literature led to the research questions.

A small body of literature has consistently identified poor disclosure quality for derivatives disclosures, which may have implications for usefulness (Chalmers & Godfrey, 2000; Ernst & Young, 2008; Papa & Peters, 2011, 2013; Roulstone, 1999; Woods & Marginson, 2004). However, the extent to which this poor disclosure quality affects users is unknown. Despite identified deficiencies, do users still find the information provided under IFRS 7 useful? Research on this topic suggests sophisticated users may be willing to search through an annual report for the information they require (Durocher & Gendron, 2010; Thinggaard, 1996), and the disclosures companies provide under IFRS 7 may be susceptible to careful analysis (Ryan, 2012). Mixed evidence of value-relevance or risk-relevance is also suggestive of a problem with the disclosures (Ryan, 2012); however, archival research does not provide further insights. For example, it does not show whether some other disclosure might be more useful than what is there (Skinner, 1996). This would be indicative of a problem with the design of IFRS 7. This led to two research questions. The first question concerned what is presently required under IFRS 7 and how companies disclose this information. The second question concerned what is not in IFRS 7 that might be useful to users i.e. the standard's design:

RQ1 Do the disclosures for derivatives made under IFRS 7 fulfil their purpose by meeting the decision making needs of users, and if not, why not?

RQ2 To the extent that the disclosures for derivatives required by IFRS 7 are not useful, what disclosures would be more useful?

Further, the literature on standard setting has expressed concern that the information needs of users of financial information are not foremost during the standard setting process (Hopwood, 1994). That is, it is possible private interests such as audit firms or large corporations have captured the standard setting process so it reflects their interests, rather than the interests of users (Suddaby, Cooper, & Greenwood, 2007). As a result, the design of IFRS 7 may be such that it should not be expected to meet the needs of users. However, little empirical research addresses this possibility. For example, although research has revealed users do not strongly participate in the IASB's formal consultations on standard setting (Jorissen, Lybaert, Orens, & Van Der Tas, 2012), little is known about the extent to which the IASB incorporates users' views into an accounting standard over time. This led to the third research question:

RQ3 Are the disclosure requirements of IFRS 7 designed to meet the needs of users, or do they preference the needs of another stakeholder group?

In order to answer the third research question, it was necessary to identify the information needs of users and other stakeholder groups that may have captured the standard setting process. As explained in Section 4.5, there is some direct evidence regarding the types of disclosures users and preparers find useful, although some categories of user, such as lenders, are underrepresented in the literature (Armstrong, Guay, & Weber, 2010). However, there is relatively little information regarding the disclosure preferences of audit firms, and even less on regulators. This is perhaps because the roles of audit firms (Suddaby et al., 2007) and regulators have changed with the advent of international standard setting.[1] Accordingly, a sub-research question was added to support Research Question 3:

SRQ3.1 What disclosure characteristics do different stakeholder groups prefer?

1.5 Theoretical Perspective

The theoretical perspective of American pragmatism, in particular the thinking of Charles Sanders Peirce, a late nineteenth century philosopher, logician, mathematician, and statistician, provided an influence on this research. As discussed in Chapter 5, the pragmatism of Peirce brings a human dimension to analytic or logical positivism that makes it both relevant and useful for research in a field such as accounting. The approach of Peircean pragmatism provides justification for research that answers the call for accounting research more closely aligned with the needs of practice (Arnold, 2009; Bricker & Previts, 1990; Carlin, 2011; Fülbier, Hitz, & Sellhorn, 2009; Granof & Zeff, 2008; Holthausen & Watts, 2001; Leisenring & Johnson, 1994; Schipper, 1994; Stevenson, 2011; Tilt, 2010).

1 The role of national regulators has changed with the advent of international standard setting, as they are now stakeholders and lobbyists in the standard setting process.

1.6 Research Design

Research design is concerned with methodology and method. That is, how a researcher goes about "finding out whatever he or she believes can be known" (Guba & Lincoln, 1998, p. 201). How a piece of research will be carried out and analysed is influenced by both the philosophical stance underpinning the research (Carson, Gilmore, Perry, & Gronhaug, 2001; Crotty, 1998; Guba & Lincoln, 1998), as well as questions of methodological fit (Edmondson & McManus, 2007). Peircean pragmatism requires an empirical approach that recognises knowledge is relative to human experience and data must be interpreted. This was suited to research that seeks to make a practical contribution on a complex issue. Both qualitative and quantitative research is possible in this paradigm. However, qualitative research is suited to answering *how* and *why* questions concerning complex social phenomena in an exploratory setting (Edmondson & McManus, 2007). A qualitative approach was therefore the best fit for the present research. Two qualitative studies were undertaken in order to answer the research questions.

The aim of the first study was that of the overarching research objective: To explore whether the derivatives disclosures required by IFRS 7 provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons. This encompassed how companies apply the disclosure requirements of IFRS 7 within their annual reports, as well as potential issues with the design of IFRS 7. The research method comprised semi-structured interviews with credit-side analysts from Australia's largest banks, and answered the first two research questions.

The aim of the second study was to evaluate decision-usefulness from the perspective of the design of IFRS 7. The research method comprised a content analysis of documents covering the development of IFRS 7 over a ten-year period from 2004 to 2014 and answered the third research question and sub-research question. Conceptual framing or theorising, provides a way of interpreting and explaining actions and events (Llewelyn, 2003). For the first study, there was no ex ante theorising as the goal was to obtain the views of the analysts rather than impose the views of the researcher. In the second study, the economic theory of regulation advanced by Stigler (1971) justified an economic incentives approach and supported a rational evaluation of results. Table 1.1 summarises the research design.

Table 1.1 Summary of research design

Research Objective	To explore whether the derivatives disclosures required by IFRS 7 provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons.	
Study	**Study 1**	**Study 2**
Aim	To explore whether the derivatives disclosures required by IFRS 7 provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons.	To explore decision-usefulness from the perspective of the design of IFRS 7.
Research questions	RQ1: Do the disclosures for derivatives made under IFRS 7 fulfil their purpose by meeting the decision making needs of users, and if not, why not? RQ2: To the extent that the disclosures for derivatives required by IFRS 7 are not useful, what disclosures would be more useful?	RQ3 Are the disclosure requirements of IFRS 7 designed to meet the needs of users, or do they preference the needs of another stakeholder group? SRQ3.1 What disclosure characteristics do different stakeholder groups prefer?
Data	In-depth interviews with 16 bank analysts.	IAS32, IFRS 7, four exposure drafts issued by the IASB, and 459 comment letters submitted to IASB in response to exposure drafts from 2004 to 2014.
Method of Analysis	Content analysis of interviews adopts an open coding approach to identify the views of the analysts.	Content analysis of documents adopts an economic incentives approach to understand stakeholder lobbying behaviour and outcomes. Findings interpreted through the lens of economic theories of regulation.

1.7 Results

Evidence from both studies shows users want better information about companies' risk management strategies and risk exposures. While IFRS 7 gives companies the flexibility to provide this information, companies resist, ostensibly on the grounds of commercial sensitivity. Although the second study concluded that IFRS 7 has evolved to favour the economic interests of audit firms, on this issue, audit firms supported the improved disclosure of risk management and risk, and their interests aligned with the interests of users. The resistance of companies to providing this information, combined with flexible disclosure requirements in IFRS 7, was identified as the main obstacle to decision-usefulness.

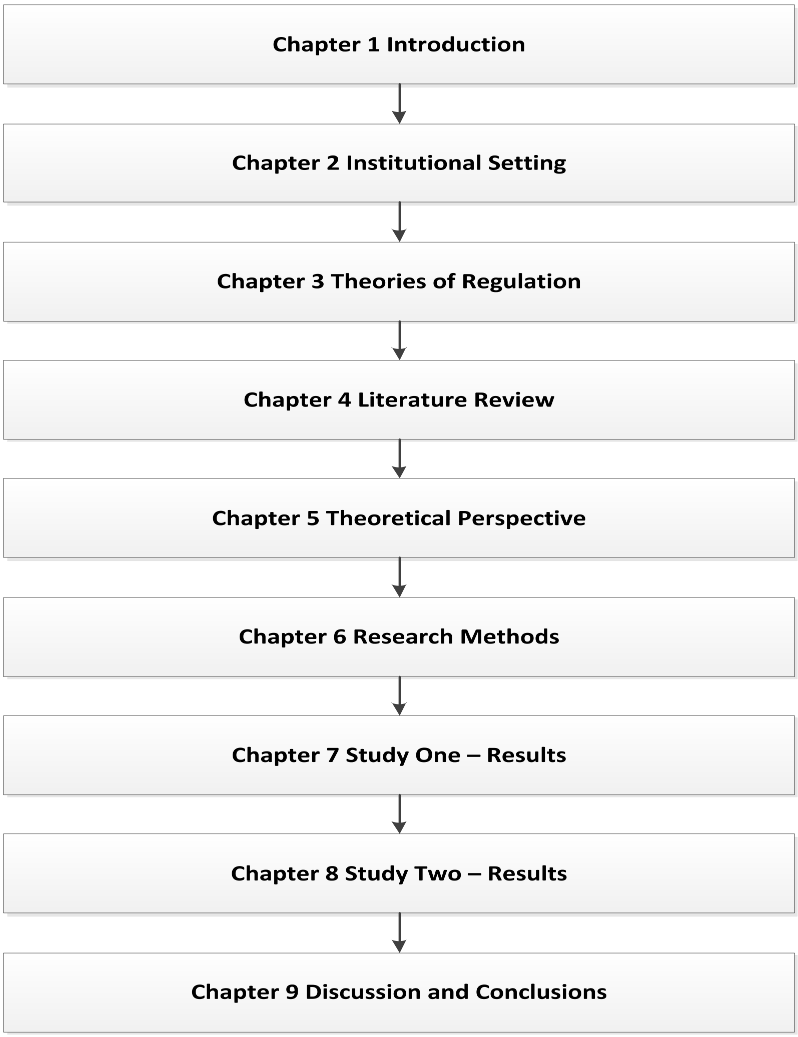
1.8 Contribution and Limitations

The results of the first study extend existing archival and survey research. They increase knowledge of the informational requirements of lenders, an important class of financial statement user. The first study supports the IASB's disclosure recommendations in its exposure draft, the Conceptual Framework for Financial Reporting (IASB, 2015d), but at the same time highlights that for the proposed measures to be successful, the IASB may need to address other issues in relation to IFRS 7. The results of the second study provide new evidence about the disclosure preferences of stakeholders to the international standard setting process, and the types of argument most likely to influence the IASB. Where earlier research identified a pluralistic standard setting process influenced by preparers, this research shows that a different pattern emerges over a longer period. The research findings highlight to the IASB that the disclosure of risk management and risk is strongly demanded by users, and strongly resisted by companies.

The limitations of this research include the small sample of interviewees from one category of user, analysis of a single disclosure standard, and limited generalisability. However, these were compensated for in part by the expertise of the interviewees and the economic importance of the disclosure standard, IFRS 7.

1.9 Summary

This chapter identified the objective of the thesis: to explore whether the derivatives disclosures required by IFRS 7 provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons. Possible reasons why the disclosures may not be decision-useful were identified through a review of existing literature and gaps in the literature led to the research questions. Two qualitative studies answered the research questions and met the overarching objective. The structure of the thesis is as follows:



Chapter 2 provides the institutional background necessary to understand derivatives, the international standard setting process, and the history of IFRS 7. Chapter 3 outlines interest theories of regulation that provide a conceptual framework for understanding standard setting, and in particular, the economic theories of regulation used in the second study. Chapter 4 sets out the literature that supports the research questions. Chapter 5 describes the theoretical perspective that underpins the research methods in Chapter 6. Chapter 7 provides the results for the first study and discusses the implications. Chapter 8 provides the results and implications for the second study. Chapter 9 draws conclusions about the overarching research objective and sets out contributions, limitations, and opportunities for future research.

CHAPTER 2 INSTITUTIONAL SETTING

Chapter 1 introduced and summarised the research. This chapter provides background information regarding the nature of derivatives, the standard setting process, and the development of IFRS 7. Section 2.1 explains how derivatives work and why their disclosure is important. Section 2.2 provides an overview of the current (2015) structure of the IASB and its due process. Section 2.3 tracks the history of standard setting for derivatives, which provides a framework for understanding the IASB's due process in the present context, and how IFRS 7 developed during the period under examination.

2.1 Derivatives and risk

Under IAS 39 Financial Instruments: Recognition and Measurement (IAS 39) (IASB, 1998), a derivative is a contract whose fair value derives from changes to one or more underlying variables. Common types of derivative are swaps, options and futures contracts. The underlying variables in a derivative contract are applied to a notional amount, and the contract is settled at a future date. Examples of underlying variables are an interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating, or credit index. Examples of a notional amount are dollars or bushels of wheat. Companies are required to recognise derivatives in their balance sheets at fair value (IASB, 1998), and as fair value derives from the underlying variables, *it is only through disclosure that a user of financial statements can understand the balance sheet valuation including valuation methods and assumptions, and the sensitivity of the valuation to the underlying variables*.

The cost of buying a derivative contract is the charge the originator of the contract, often a bank, makes to arrange the transaction. By adjusting margins or some of the terms and conditions, the originator can ensure that the cost of a derivative to the purchaser is very low. The initial cost of a derivative is required to be either zero or a nominal amount unrelated to the notional value of the contract (IASB, 1998). It is this requirement that differentiates a primary financial instrument, such as a bank loan, from a derivative. This means that for a relatively low cash outlay, derivatives can provide exposure to changes in underlying variables for very large notional values. *It is only through disclosure that a user of financial statements can understand the nature, extent, and timing of companies' risk exposures.*

Companies enter into derivatives contracts either to increase or decrease risks. Derivatives can be part of a company's risk management strategy and used appropriately, reduce, or mitigate business risks. This is *hedging* and it is conceptually similar to buying insurance. Derivatives not used for hedging are used for speculation, and increase business risk. An example of using a derivative for hedging might be if an Australian trader has an obligation to settle a debt in a foreign currency in three months' time. The trader could make certain of the future cash out-flow by entering into a swap to sell Australian currency and buy the applicable foreign currency in three months, at an exchange rate agreed upon today. To the extent that the terms of the foreign currency swap exactly match the terms of the future obligation, the trader would either reduce or eliminate exposure to fluctuations in the exchange rate. If the same trader entered into the same derivative contract without having an existing foreign currency payable, then business risk would be increased. The trader is speculating that the two currencies will move in a favourable direction between the date of the derivative contract and settlement date. *It is only through disclosure that a user of financial statements can know whether a company's purpose in holding derivatives is to hedge or speculate.*

It is therefore clear that the recognised amount of a derivative has relatively little information value without appropriate disclosure. Fair value may be "the best single number that we can put into the accounts, but, on its own, without that ecosystem of information, it is relatively meaningless" (Lee, 2012, p. 326).

The following two sections explain the structure of the IASB and its due process, and then document the development of IFRS 7 from its inception in 2004 to the end of 2014.

2.2 The Standard Setting Process

The IASB is the independent standard setting body of the International Financial Reporting Standards (IFRS) Foundation. Figure 2.1 shows the organisational structure of the IFRS Foundation.

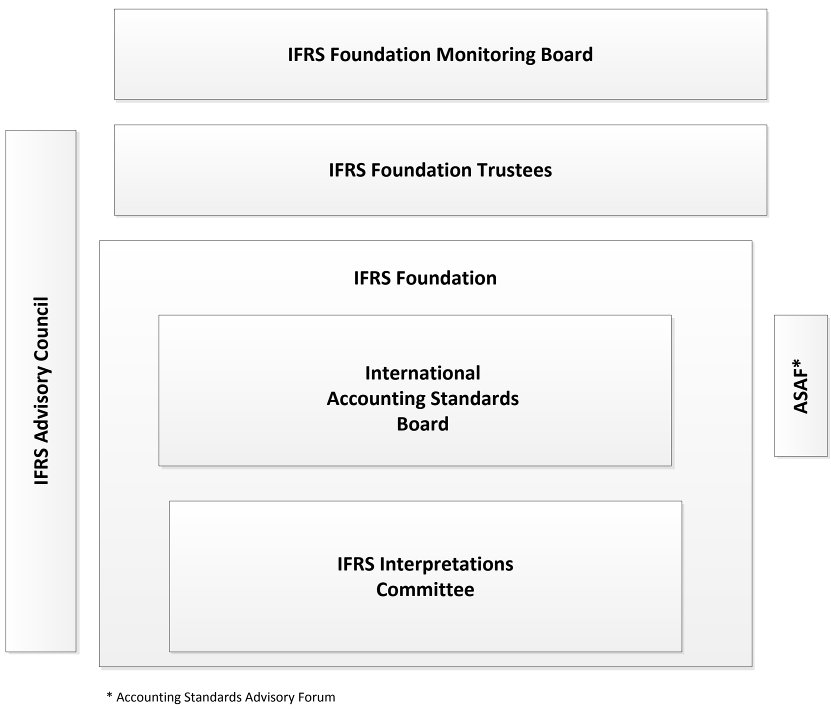


Figure 2.1 Structure of the IFRS Foundation

Adapted from: IASB (2015b)

The IFRS Foundation is subject to considerable oversight. Constituted in 2009, the IFRS Foundation Monitoring Board provides the highest level of oversight. Its members are representatives of capital market authorities responsible for standard setting (IASB, 2015i). The IFRS Foundation Trustees are responsible for governance of the IFRS Foundation and answer to the monitoring board (IASB, 2015l). Most, but not all of the trustees have a regulatory or standard setting background. Neither the IFRS Foundation Monitoring Board nor the IFRS Foundation Trustees are involved in standard setting and their positions are not full-time.

The IFRS Foundation comprises two bodies; the IASB responsible for standard setting, and the IFRS Interpretations Committee that provides consensus views and interpretations on current accounting issues (IASB, 2015g). The IASB has 14 full time members responsible for the development and publication of IFRS. It is a requirement that IASB members are independent experts with a mix of recent practical experience in setting accounting standards; in preparing, auditing, or using financial reports; or in accounting education (IASB, 2015h). Broad geographical diversity is also required (IASB, 2015h). The IASB members receive advice from a number of advisory committees, including the IFRS Advisory Council and the Accounting Standards Advisory Forum. The IFRS Advisory Council is the formal advisory body to both the IASB and the trustees of the IFRS Foundation and consists of representatives from all stakeholder groups affected by and interested in the IASB's work (IASB, 2015e). The Accounting Standards Advisory Forum comprises representatives from 12 geographically diverse standard setting bodies.

The IASB explains the standard setting process on its website (IASB, 2015k). Due process begins with an item added to the IASB's work plan in response to a need for information by investors or other capital market participants. The IASB identifies this need in various ways such as through the research and stakeholder outreach activities of its staff, the IFRS Advisory Council, the IFRS Interpretations Committee, and national standard setters. The IASB's discussions of potential projects and its decisions to adopt new projects take place in public board meetings and in consultation with the IFRS Advisory Council and national accounting standard setting bodies. Once the IASB has added an item to its agenda, a decision is made whether to undertake the project independently or in conjunction with another standard setter. For larger or more complex projects, a consultative group may be established.

Although a discussion paper is not mandatory, the IASB normally publishes one as its first publication on any major new topic to explain the issue and solicit early comment from stakeholders. A discussion paper will include an overview of the issue, dissenting views, and the IASB's preliminary view, followed by an invitation to comment. The IASB may also hold public meetings to discuss issues and conduct other outreach activities. Irrespective of whether the IASB has published a discussion paper, they must publish an exposure draft as a mandatory step in their due process.

An exposure draft takes the form of the standard it proposes to add to or amend and includes an invitation to comment. After resolving issues arising from public comment on exposure drafts, the IASB considers whether it should expose any revised proposals to public comment, for example by publishing a second exposure draft. When satisfied that it has reached a conclusion on the issues arising from the final exposure draft, the IASB instructs its staff to draft the IFRS. A majority of the members of the IASB must approve all discussion papers, exposure drafts, and the IFRS before issue.

The IASB invites public comment on all proposals published as a discussion paper or exposure draft. The length of time that the comment period is open varies; however, for major projects the IASB will normally allow a period of at least 120 days for comment. To give the public timely access to the comment letters, IASB staff regularly post the letters online. The IASB members review comment letters within the comment period and IASB staff normally provide a summary and analysis of the comments. IASB staff post these summaries on the relevant project page of the website. Once board members have considered the views received in comment letters, a position summary is posted on the website summarising the major points raised in the letters. In addition, in the basis for conclusions on each pronouncement, the IASB responds to the main issues raised in the comment letters received.

2.3 History of IFRS 7

The history of financial statements disclosure for derivatives intertwines with the history of their recognition and measurement. There have been two major financial instruments projects undertaken by the International Accounting Standards Committee (IASC) and its successor the IASB, both of which had implications for the disclosure of derivatives. Between these two projects, the IASB made several substantive changes to the disclosure of financial instruments that affected derivatives. Figure 2.2 shows the history of the applicable accounting standards.

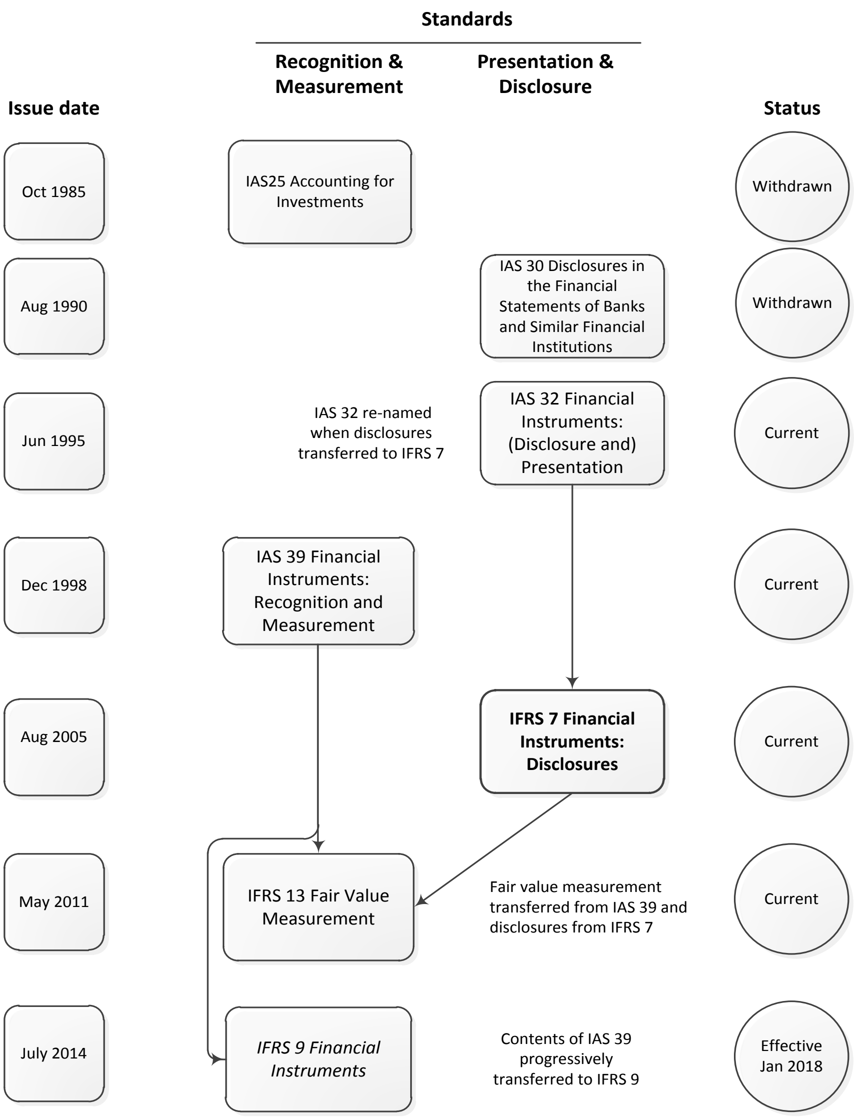


Figure 2.2 History of accounting standards for financial instruments

2.3.1 The first major financial instruments project

When the first major project on financial instruments commenced in 1988, there was no acknowledgement of financial assets, financial liabilities or derivatives in any international accounting standard. IAS 25 Accounting for Investments (IAS 25) was the most relevant international standard. It comprised fourteen paragraphs and covered recognition, measurement, and disclosure of investments as diverse as commodities, investment properties, and financial investments, including derivatives. Historical cost was the benchmark treatment, with market value a permitted alternative determined primarily by management intent. Disclosure requirements were minimal and companies had significant discretion. Standards in Australia, the UK, and Europe were similar to IAS 25, although the US was beginning to issue separate standards for financial instruments on a piecemeal basis (IASB, 2003). The scope of the first international financial instruments project was consequently ambitious: it was to encompass recognition, measurement, presentation, and disclosure, plus hedge accounting.

Camfferman and Zeff (2007) documented the progress of the first major financial instruments project, which began with strong committee participation from members of the IASC. However, early signs of future conflicts were evident when it was unknown which of two benchmark measurement approaches would be approved by the board up to the date of the first exposure draft in 1991 (Camfferman & Zeff, 2007). Divided by increasingly entrenched views on measurement, the IASC issued discussion papers and exposure drafts in succession, shifting between an intent-based mixed measurement model and a full fair value model for financial instruments (IASB, 2003). In 1995, the IASC split the financial instruments project in two and issued the less controversial presentation and disclosure standard, IAS 32. Then, in 1998, the IASC settled on a compromise over recognition and measurement that became IAS 39 (Camfferman & Zeff, 2007). Intended as an interim solution, IAS 39 had an intent-based mixed measurement model with no full fair value option. Australia voted against IAS 39 and the US, UK, and France abstained (Camfferman & Zeff, 2007).[2]

[2] Although based on the existing US model, the US had wanted the international standard to be an improvement of what they saw as the limitations of their own system, not a replication of it. They also had issues with procedural deficiencies. The UK and Australia favoured full fair value accounting, while France had concerns regarding the reliability and prudence of the standard. France also disagreed with the board's refusal to address macro hedging in IAS 39 (Camfferman & Zeff, 2007).

There was little question that derivatives would be measured at anything other than fair value throughout the first financial instruments project, as measuring derivatives at cost essentially takes them off balance sheet. Problems the project had with derivatives tended to be more technical. Rapid advances in financial engineering made it difficult for committee members to keep up to date, not only on the advances, but also on their full implications (Camfferman & Zeff, 2007). There was disagreement over hedge accounting, but much was overshadowed by the debate about measurement (Camfferman & Zeff, 2007).

2.3.2 Evolution of the disclosure standards

In 1995, the IASC issued the first disclosure standard, IAS 32, during the course of the first major financial instruments project. IAS 32 contained disclosures that had significance for derivatives, as well as for other financial instruments. It required appropriate classification of financial instruments; disclosure of accounting policies; a description of the terms and conditions of financial instruments by class, or individually if material; the disclosure of hedging transactions; information on fair value calculations including methods and assumptions for non-market based valuation inputs; and disclosures for assets partially or fully derecognised. However, IAS 32 had relatively few specific requirements for the disclosure of financial risks. It had a principles-based requirement for companies to explain their risk and risk management practices, but was not prescriptive beyond a requirement to disclose information about interest rate risk and credit risk.

Between the issue of the first disclosure standard, IAS 32, in 1995, and the IASB taking over responsibility for standard setting in 2001, changes made to IAS 32 were relatively minor. A financial instruments improvement project instigated by the IASB in 2001, while resulting in a number of technical changes for IAS 39, did not significantly affect IAS 32. However, at the same time, the IASB began an examination of industry standard, IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions (IAS 30). Originally issued in 1990, IAS 30 required additional disclosures for the financial instruments of regulated deposit-taking institutions, some of which applied to derivatives. By late 2002, the IAS 30 project had been expanded and eventually led to the disclosure requirements of both IAS 30 and IAS 32 forming the foundation of IFRS 7, a new general disclosure standard for financial instruments (Deloitte, 2015). Recognising the increasing exposure of non-banks to the kind of risks traditionally associated with the financial services sector (IASB, 2004), IFRS 7 combined the financial instrument disclosures of IAS 32 with the risk disclosure requirements of IAS 30, and increased the disclosure of financial risk for all companies. The IASB issued IFRS 7 in 2005, with an effective date from 1 January 2007.

Subsequent amendments to IFRS 7 affecting derivatives have mainly been in response to problems identified from the 2007/8 financial crisis and in furtherance of US convergence. In November 2006, the IASB issued a discussion paper, Fair Value Measurement (IASB, 2006a, 2006b). This discussion paper contained proposals intended to replace fair value measurement guidance held within individual IFRSs with a single, unified definition of fair value, and further authoritative guidance on the application of fair value measurement in inactive markets. Based upon US standard, Statement of Financial Accounting Standard 157 Fair Value Measurement (SFAS 157), the IASB discussion paper introduced the concept of a fair value hierarchy based upon the observability of inputs used in valuations. By close of the comment period in April 2007, the IASB had received 136 comment letters. However, overtaken by the events of the 2007/8 financial crisis, in April 2008, the Financial Stability Board (FSB) (2008, p. 56) urged the IASB to "strengthen its standards to achieve better disclosures about valuations, methodologies and the uncertainty associated with valuations." [3]

[3] Established by the Group of 20 nations (G20) in 1999, the Financial Stability Board (FSB) succeeded the Financial Stability Forum in 2009. The FSB is charged with responsibilities relating to the coordination of work

In May 2008, the IASB formed an expert advisory panel, the purpose of which was to consider best practice for measuring and disclosing the fair value of financial instruments in markets that were no longer active (IASB, 2008d). Within a month of receiving the panel's report, the IASB had exposed for public comment ED/2008/10 Improving Disclosures about Financial Instruments. ED/2008/10 contained two key disclosure recommendations made by the expert panel, to introduce a three-level fair value hierarchy that distinguished between the observability of inputs into valuation models, and to increase the disclosures for valuations reliant upon management originated inputs (IASB, 2009b). As the amendments in ED/2008/10 pre-empted completion of the fair value measurement project by several years, the IASB was proposing disclosures referencing a hierarchy that was not included in IAS 39 or elsewhere. [4] The IASB adopted amendments to IFRS 7 resulting from ED/2008/10 in March 2009, and reflecting the perceived urgency of the changes, backdated the effective date to January 2009.

In addition to its instructions concerning fair value, the FSB (2008, p. 56) also required that the IASB "improve the accounting and disclosure standards for off-balance sheet vehicles on an accelerated basis and work with other standard setters toward international convergence." Derecognition under IAS 39 was at that time complicated by internal inconsistencies within the standard. The IASB claimed that combining different derecognition concepts and terminology, e.g. risks and rewards, control, and continuing involvement, made the standard difficult to interpret and apply (IASB, 2009a). Accordingly, in April 2009, and without prior public consultation, the IASB issued exposure draft ED/2009/3 Derecognition. ED/2009/3 proposed a new basis for derecognition and made changes to IFRS 7 aimed at enhancing

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of international standard setters and national financial authorities, monitoring of country compliance with international standards, and addressing developments in financial stability (Davis, nd).

[4] Following the initial 2006 discussion paper, the IASB issued two exposure drafts on fair value measurement in 2009 and 2010, and issued IFRS 13 Fair Value Measurement in 2011.

users' ability to evaluate the risk exposures that sometimes remain after derecognition (IASB, 2009a). The IASB adopted amendments to IFRS 7 resulting from ED/2009/3 in October 2010.

2.3.3 The second major financial instruments project

In March 2008, ten years after the IASC adopted IAS 39 as an interim solution, the IASB published a discussion paper, Reducing Complexity in Reporting Financial Instruments (IASB, 2008b), which initiated a second major project on accounting for financial instruments. An acknowledged reaction to failures during the financial crisis, this discussion paper attributed much of the complexity in reporting financial instruments to the many ways they are measured and the complexity of the associated rules (IASB, 2008b). The IASB divided its second major financial instrument project into three phases. These were classification and measurement, impairment, and hedge accounting. In July 2014, having completed the three phases, the IASB issued IFRS 9, which has an effective date of January 2018, with early adoption permitted. Of relevance to derivatives, the IASB completed the general hedge accounting phase of IFRS 9 in November 2013. Figure 2.3 shows the disclosure approaches for hedges before and after companies adopt IFRS 9.

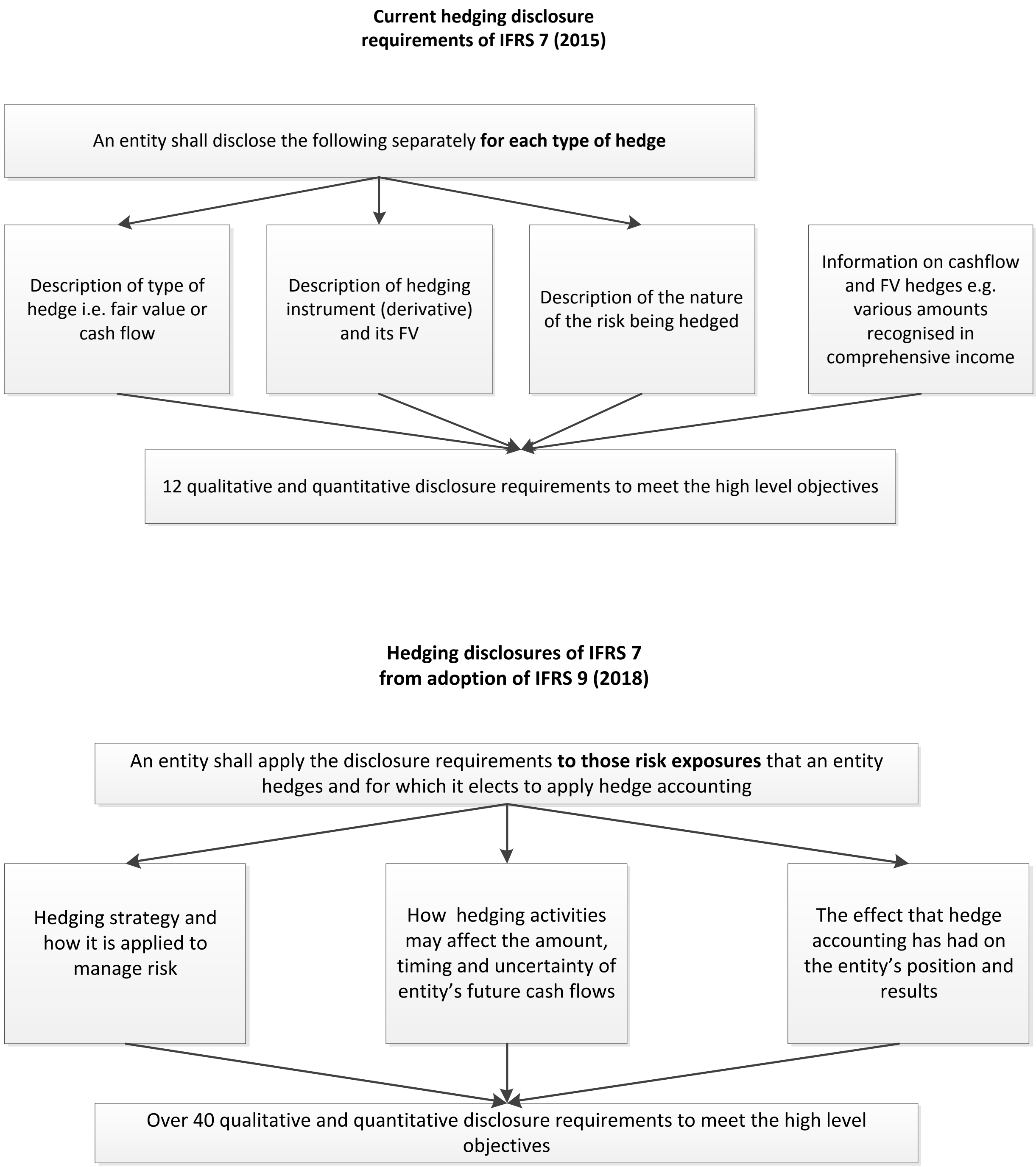


Figure 2.3 Comparison of current hedge disclosure requirements with requirements following adoption of IFRS 9

IFRS 9 introduced a new hedge accounting model that the IASB intends will align hedge accounting more closely with companies risk management activities (IASB, 2010b). As this means companies will be able to designate more transactions as hedges, the second objective of this phase of the financial instruments project was to improve the ability of investors and other users to understand risk management activities, and assess the amounts, timing, and uncertainty of cash flows through increased disclosure (IASB, 2014c). A separate project on macro or portfolio hedging is ongoing. Appendix A provides a list of all amendments to the financial instrument disclosure standards from the issue of ED 7 in 2004 to the end of 2014, highlighting amendments applicable to derivatives discussed in this section.

2.4 Summary

This chapter provided the institutional background to this research. It explained that the most important characteristics of derivatives cannot be known from their recognised amounts and must be explained through transparent disclosure. The structure of the IASB and its due process were described including opportunities for stakeholder involvement in the standard setting process, followed by the history of international standard setting for financial instruments and derivatives. This demonstrated how IFRS 7 has developed over time, some of the political pressures that have faced the standard setter, and that improvements to the disclosure of derivatives have often been a reactive process. Chapter 3 introduces the theories of regulation that provide a framework for understanding the standard setting process and the second study in this thesis.

CHAPTER 3 THEORIES OF REGULATION

Chapter 2 provided the institutional background necessary to understand this research. It explained why disclosure is important for derivatives, the structure and processes of international standard setting, and the development of IFRS 7. The theories of regulation described in this chapter provide a lens through which the standard setting process can be understood. Section 3.1 overviews several theories that explain the drivers of regulation and regulatory behaviour. Section 3.2 discusses public interest theory. Section 3.3 extends public interest theory with the political theory of regulatory capture. Section 3.4 then introduces the economic theories of regulation that combine earlier political and economic explanations of regulatory behaviour and develop a testable model. Economic theories are used to interpret the findings of the second study.[5]

3.1 Theories of Regulation

Most theories of regulation can be divided into two broad camps: public interest theories and private interest theories (Mitnick, 1980).[6] These correspond to a view of regulators as either "other-regarding" or "self-regarding" (Mitnick, 1980, p. 85). While public interest theories may explain how the IASB sees its role, and political capture theories provide a useful descriptive model, it is the economic theories of regulation that support the economic incentives approach taken in the second study and justify the inferences made.

[5] As explained in Section 1.6 and Section 6.2.4 the first study was not explicitly theorised.

[6] Many theories may be used to understand regulation, and many are variations on the interest theories discussed here. However, there are other theoretical perspectives that are quite different. Institutional theorists, for example, reject the rational actor model arguing that "institutional structure and arrangements, as well as social processes, shape regulation" (Gaffikin, 2008, p. 81). Other theories completely reject neo-classical assumptions (Gaffikin, 2008).

3.2 Public Interest Theory

Public interest theory asserts that regulation is developed in response to demand from the public for the correction of an inefficient or inequitable market (Levine & Forrence, 1990; Peltzman, 1989; Posner, 1974). A belief that markets are inefficient and regulation is the "cure", underpins virtually all public interest accounts of regulation (Levine & Forrence, 1990, p. 168). In the public interest perspective, regulators are assumed to act for the benefit of others and not for their own benefit (Levine & Forrence, 1990). Public interest theory therefore reflects an expectation of how public servants should behave (Levine & Forrence, 1990). Although empirical research shows that regulators do not always act in the interests of the public, they sometimes do (Levine & Forrence, 1990), and public interest theory continues to have currency (Gaffikin, 2008).

A feature of public interest theory is that it contains no linkage or mechanism by which perceptions of public interest are defined and then translated into legislative action (Mitnick, 1980; Posner, 1974). This makes "determining what is in the public interest … a normative question" (Gaffikin, 2008, p. 79). Accordingly, the IASB have created their own linkage, defining their public interest objective in terms of the promotion of growth and long-term stability in global financial markets (IASB, 2015a). The Conceptual Framework elaborates the IASB's public interest objective in the objective of financial reporting, which is:

> …to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit (IASB, 2010a para.OB2).

The IASB makes its objective of financial reporting operational through the objective of each accounting standard. For IFRS 7, information will be decision-useful if it enables users to evaluate the significance of financial instruments for an entity's financial position and performance, the nature and extent of risks arising from financial instruments to which an entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks (IASB, 2005).

Consistent with the view of regulators acting in the public interest, the IASB strives to act in the best interests of the capital market participants it identifies as *users*. It achieves this by promulgating accounting standards that are, by its own definition, decision-useful. However, as stated, public interest theory is not always borne out by evidence (Levine & Forrence, 1990; Peltzman, 1989; Posner, 1974), and the failure of regulation to achieve a public interest objective is not uncommon (Deegan, 2014). In response, public interest theorists have advanced reasons as to why, if regulators act honestly in the public interest, they may not succeed. One suggestion is that regulatory agencies are created for genuine public purposes, but are then mismanaged, with the result that high ideals are not achieved (Mitnick, 1980; Posner, 1974). Alternatively, areas where regulation is deemed necessary are often intractable by nature, and this is compounded by the high cost of negotiating with large numbers of stakeholders in a political setting (Ehrlich & Posner, 1974; Posner, 1974). This last interpretation of regulatory failure is consistent with those that question whether financial reporting is ever likely to be:

> …up to the task of providing transparency to capital markets within the hyper financialized economy of the 1990s and 2000s where the combination of uncontrolled financial innovation, complex financial instruments, deregulation, moral hazard, and the consolidation of economic and political power within

> the financial sector [has] rendered the financial system increasingly ungovernable (Arnold, 2009, p. 807).

The implication of public interest interpretations of regulatory failure is that regulatory failure will become, on average, a more serious problem over time (Posner, 1974). This would be consequential for the IASB and the market.

3.3 Regulatory Capture Theory

An alternative perspective of regulatory failure within a public interest framework is that although regulators may begin with the aim of protecting the public interest, they will ultimately come under the control of, or be captured by, those that they regulate (Mitnick, 1980; Posner, 1974). Mitnick (1980, p. 95) defined "capture" to include direct and indirect control. Control can be exercised indirectly through coordination of activities between regulator and regulated so that private interests are served, ensuring that a regulator is ineffective or neutralised, and co-opting a regulator so that they come to share the perspective of the regulated (Mitnick, 1980). The basic structure of a rewards system may also have the effect of aligning the interests of a regulator with those of the regulated (Mitnick, 1980).

Although potentially relevant in the context of the present research, there are questions that this version of capture theory, with its origins in the field of political science, cannot answer. First, it does not explain why the regulator should (or would) have a public interest motive (Levine & Forrence, 1990; Posner, 1974). Second, it has no ability to differentiate when there is more than one regulated group (Posner, 1974). In the context of international standard setting, both preparers and audit firms are regulated groups with potentially conflicting interests.

3.4 Economic Theories of Regulation

Economic theories of regulation are an extension of political capture theory (Peltzman, 1989).[7] Premised on the notion that the most politically effective private interests will dominate the regulatory process, economic theories of regulation take no account of public interest motivations (Deegan, 2014; Posner, 1974). Whilst having a long history, the most influential of the economic theorists was Stigler (1971), who combined existing research into capture theory with new economic analysis (Mitnick, 1980). Unlike earlier theorists, Stigler attempted to develop an explicit, testable model of regulation (Mitnick, 1980; Peltzman, 1989; Posner, 1974).

Stigler (1971) saw regulation as a product like any other, subject to the laws of supply and demand, and concluded that all actors would act rationally to advance their own economic interests. Through regulation, regulators have the ability to impose costs and confer benefits. In this, Stigler directed attention to factors bearing on the value of regulation to particular individuals or groups; as, other things being equal, a product is supplied to those who value it the most. Identifying that the regulated industry would usually have a higher individual per capita stake than the public the regulation was intended to benefit, Stigler concluded that regulation would be acquired by the regulated industry, and be designed and operated primarily for its benefit.

In reaching this conclusion, Stigler (1971) also directed attention to factors bearing on the cost of obtaining regulation. Smaller well-organized groups will usually benefit the most from regulation, as their cost of organisation is relatively lower than larger and more diffuse groups. Smaller groups are more homogeneous in their preferences and have fewer free riders

[7] Economic theories of regulation are also called economic theory, private interest theory, public choice theory, and capture theory (Gaffikin, 2008)

that do not contribute resources. That the public is generally more diffuse, more diverse, and has more free riders, increases their cost of organisation relative to the regulated industries (Peltzman, 1976; Posner, 1974; Stigler, 1971). The publics’ lower per capita stake in the regulation and relatively higher cost of organisation also explains why they tend not to complain when regulation does not prioritise their interests (Stigler, 1971).

In Stigler’s view of regulatory behaviour, regulators will act in their own self-interest, with goals such as job retention, securing and enhancing power, and personal wealth after the period of office-holding ends (Levine & Forrence, 1990). As such, interest groups can influence the outcome of the regulatory process by providing financial or other support. In a political context, this is usually in the form of “votes and money” (Peltzman, 1989, p. 6). The IASB, lacking the coercive power of government, is dependent upon its major stakeholders both for financing (money), and for their continued support for international standards (votes). The IASB is also dependent upon its major stakeholders to provide its office-holders and for the provision of technical expertise.

Stigler (1971) identified ways in which the power of a regulator to grant benefits to interest groups is restricted, including the extent of procedural safeguards and admission of powerful outsiders to the political process. The IASB is subject to oversight from bodies that draw their members from all stakeholder groups. The IFRS Foundation Monitoring Board comprises national and supranational capital market regulators and provides the highest level of oversight; the IFRS Foundation Trustees are responsible for governance and answer to the monitoring board. Neither of these bodies is involved in standard setting. The IASB is further constrained by a public due process. Powerful outsiders are admitted to the process, including national and supranational regulators and the governments behind them. Regulators not only comprise members of the monitoring board and a majority of the trustees of the IFRS

Foundation, the IASB consults with them on all aspects of the standard setting process. Regulators have no direct economic incentive in the product of regulation, as they are neither the regulated nor consumers of regulation.

Stakeholders with a direct economic interest in the regulatory process will act to influence the regulator to maximise their own profitability. However, they are not interested in any concept of aggregate wealth (Stigler, 1971). This is why regulated industries prefer controls over entry, or limits on the growth of new entrants, to a shared benefit. A central hypothesis is that "every industry or occupation that has enough political power to utilize the state will seek to control entry" (Stigler, 1971, p. 5).

3.5 Summary

This chapter identified three theories of regulation that may be used to understand international standard setting. Public interest theory may explain the explicit motivation of the IASB, while capture theories and economic theories of regulation provide a means to differentiate between stakeholders and identify their motivations from their economic incentives. Chapter 4 introduces the literature that supports and justifies this research.

CHAPTER 4 LITERATURE REVIEW[8]

Chapter 3 discussed theories of regulation that may be used to understand international standard setting and the economic theories that provided a conceptual framework for the second study. This chapter reviews the literature that supports the research questions in Section 1.4. The first two sections in this chapter support the first two research questions:

RQ1 Do the disclosures for derivatives made under IFRS 7 fulfil their purpose by meeting the decision making needs of users, and if not, why not?

RQ2 To the extent that the disclosures for derivatives required by IFRS 7 are not useful, what disclosures would be more useful?

Section 4.1, identifies and describes disclosure quality issues raised in the IFRS 7 literature, and Section 4.2 evaluates the implications of archival and other literature that address aspects of the usefulness construct for IFRS 7. The next three sections support the third research question:

RQ3 Are the disclosure requirements of IFRS 7 designed to meet the needs of users, or do they preference the needs of another stakeholder group?

Section 4.3 evaluates the literature on public lobbying during the IASBs due process on new accounting standards, while Section 4.4 analyses the political environment within which standard setting takes place and other paths to influence.

[8] Sections 4.1 and 4.2 contain material published in Bean and Irvine (2015)

Finally, Section 4.5 explains what is known about the information preferences of stakeholders in the standard setting process and propositions are made to support the testing of sub-research question 3.1:

SRQ3.1 What disclosure characteristics do different stakeholder groups prefer?

4.1 IFRS 7 Disclosure Quality Research

The IASB considers it important that disclosures for financial instruments, including derivatives, satisfy two broad objectives, both of which are necessary for users to understand these instruments. The first objective is to provide users of financial statements with an understanding of the significance of derivatives for a company's financial position and performance, that is, an explanation of recognised amounts (IASB, 2005 para.1(a)). The second, equally important objective, is to provide users with information about companies' exposure to the risks associated with those recognised amounts, and to provide an understanding of why management entered into those risks and how they are managed (IASB, 2005 para.1(b)). Disclosures of transferred financial assets supplement the other disclosure requirements of IFRS 7 (IASB, 2005 para.42A). Figure 4.1 summarises the main requirements of IFRS 7 that apply to derivatives.

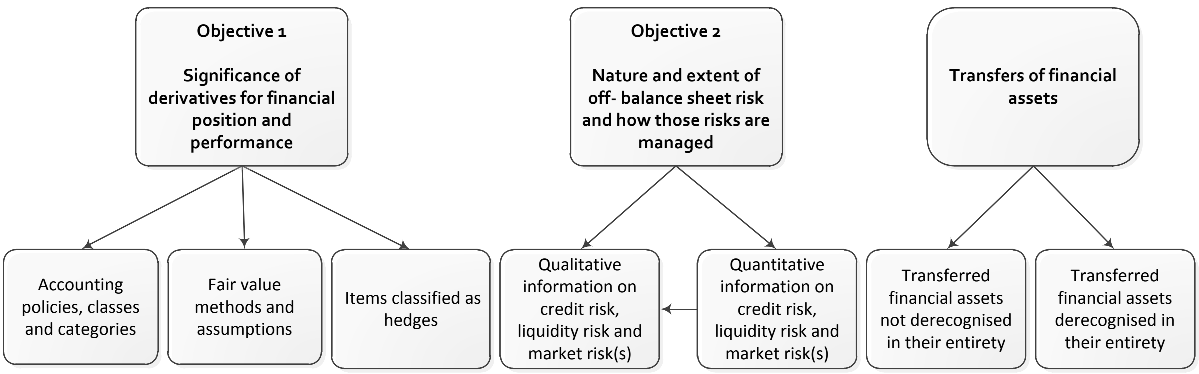


Figure 4.1 IFRS 7 disclosures most relevant to derivative financial instruments

Significance of derivatives for financial position and performance

Requirements applicable to derivatives under the first objective depicted in Figure 4.1 include appropriate levels of aggregation and disaggregation, accounting policies, disclosures for items measured at fair value, and information on hedging transactions.[9]

IFRS 7 requires companies to group financial instruments into classes appropriate to the nature of the information disclosed. While companies determine the level of aggregation they believe is necessary, IFRS 7 provides that, at a minimum, companies not combine information with different measurement characteristics. Companies are also required to disclose their accounting policies such that users may understand the financial statements. Recent research has indicated that not all companies may be complying with this basic requirement to provide their accounting policies for derivatives (Birt, Rankin, & Song, 2013).

Fair value measurements are classified according to a three level hierarchy determined by the observability of their inputs.[10] The standard requires the disclosure of measurement methods and assumptions with additional information on the sensitivity of the assumptions used for Level 3 valuations. Clearly, there are increasing opportunities for earnings management as the use of less observable, management originated inputs increases. Companies have also used undisclosed transfers between levels of the hierarchy to hide losses (Jones, 2011; Kothari, Ramanna, & Skinner, 2010). Accordingly, a reconciliation of movements between the levels of hierarchy has been required since 2009.

[9] In May 2011 the Board relocated the disclosures about fair value measurements from IFRS 7 to IFRS 13 Fair Value Measurement (IASB, 2011 paras. 91-99).

[10] Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability (IASB, 2011 paras. 72-90).

Hedging is a risk management strategy that involves taking an offsetting position to a risk exposure such as interest rate risk, foreign exchange risk, or commodity-price risk. IAS 39 identifies two main types of hedging strategies.[11] This recognises that companies commonly hedge both the possibility of changes in cash flows (e.g. the possibility that interest rates may fall causing interest income on a variable rate investment to fall), and the possibility of changes in fair value (e.g. the possibility that interest rates may rise, causing the value of a fixed rate investment to fall). While the two types of hedge may involve companies entering into derivatives with exactly opposite risk positions, companies desire hedge accounting for both strategies.

The purpose of hedge *accounting* is to remove timing differences caused in part by the mixed measurement model, as timing differences are not economically justified when a hedging relationship exists. IAS 39 achieves matching in one of two ways. Always requiring that derivatives are measured at fair value, IAS 39 either brings forward the recognition of gains and losses on the hedged item by measuring it at fair value (for a fair value hedge), or it defers the gain or loss on the hedging instrument (derivative) by recognising it initially through other comprehensive income (for a cash flow hedge). When the transaction associated with the cash flow hedge crystallises, the gain or loss from the hedging instrument is recycled out of equity and matching occurs in the profit and loss account. IAS 39 currently sets very strict hurdles for a transaction to qualify for hedge accounting, quite possibly due to the income smoothing opportunities inherent in hedge accounting, as well as companies' use

[11] Accounting for the third type of hedge recognised by IAS 39, a hedge of a net investment in a foreign operation is similar to a cash flow hedge. IAS 39 does not currently recognise portfolio hedges as a separate type of hedge.

of misleading language about hedging to obscure whether derivatives are for the purpose of offsetting risk or taking risk.[12]

IFRS 7 currently requires companies to disclose by type of hedge utilised, a description of the derivatives designated as hedging instruments and the nature, timing, and extent of the risks hedged. A large proportion of listed companies engage in hedging activity, with interest rate and foreign exchange risk the main risks hedged (Bodnar & Gebhardt, 1999; Chalmers & Godfrey, 2000; Heaney & Winata, 2005; Nguyen & Faff, 2002). Commodity price hedging is more common in the mining sector (Birt et al., 2013). Research conducted by practitioners has suggested that companies may fail to disclose sufficient specific information about hedges and policies on hedging, potentially limiting users' understanding of how companies manage their risks and their knowledge of whether a well-defined and well-monitored procedure for risk management exists (Papa & Peters, 2013).

A loosening of the restrictions on hedge accounting once companies adopt IFRS 9 will make the hedging disclosures even more critical.[13] Accordingly, the disclosure requirements upon adoption of IFRS 9 are fundamentally different to existing requirements, in that their starting point is the type of risk exposure, rather than the type of hedge. Companies adopting the new hedge accounting model will have to provide a description of their risk management strategy for categories of risk that they decide to hedge, how that strategy has been applied, how hedging activities might affect future cash flows, as well as the effect that hedge accounting has had on both financial position and performance. As shown in Figure 2.3 (Section 2.3.3), the IASB also increased the volume of disclosures.

[12] Companies engage in selective hedging, and in doing so, are effectively taking a view on whether market changes will benefit or disadvantage them (Bodnar & Gebhardt, 1999; Géczy, Minton, & Schrand, 2007). An example of this is the Australian mining company, Sons of Gwalia Ltd. Prior to its collapse in 2002, none of its directors, management, or the highly sophisticated institutional investors who held major positions in the company seemed to be aware that its hedging strategy was, in fact, highly speculative (Bartholomeusz, 2004).

[13] IFRS 9 effective date is January 2018, with early adoption permitted.

Nature and extent of risks and how those risks are managed

To meet the second objective of providing disclosures that enable an understanding of financial risk and risk management practices (see Figure 4.1), IFRS 7 requires that companies must disclose the financial risks to which they are exposed, which typically include credit risk, liquidity risk, and market risk. Companies must describe how each risk arises, how it is measured, management's objectives, policies and processes for managing the risk, and whether there are any changes from the previous period.

Companies are required to disclose summary quantitative information for each risk category, based on information provided internally to management. To the extent that this information is not representative of transactions during the year, a company must provide additional information. IFRS 7 mandates several minimum quantitative disclosures if they are not provided under the summary requirements. These include information on maximum exposure to credit risk, both with and without the effects of collateral; a maturity analysis for derivative financial liabilities, with contractual maturities where relevant; a description of how liquidity risk is managed; and disclosures of market risks. Market risks are key trading exposures and may include interest rate, foreign exchange rate, equity price, and commodity price risks. A sensitivity analysis is required for each type of market risk to which a company has exposure at the end of the period, showing the effect on profit or loss and equity of a specified change in the market. An alternative to a sensitivity analysis is an analysis of value-at risk (VaR), more commonly used by banks and financial institutions.

Research has shown that most quantitative disclosures of off-balance sheet risks tend to be formulaic. With credit risk for example, very few companies appear to provide specific information on concentrations of risk and credit quality of assets that are not past due or impaired (Ernst & Young, 2008; Papa & Peters, 2011). For liquidity risk, research has found that the majority of companies do provide required quantitative information on undiscounted cash flows, but fail to consistently provide sufficient detail in narrative disclosures (Ernst & Young, 2008). For market risk, most criticism has been directed at companies' lack of disclosure of methods, inputs, and assumptions applied in the sensitivity analysis (Ernst & Young, 2008; Papa & Peters, 2011). In addition to criticism levelled at the narrative disclosure of methods and assumptions underlying the quantitative disclosures, the disclosure of managements' objectives, processes, and policies for managing these risks is considered generic and uninformative (Chalmers & Godfrey, 2000; Ernst & Young, 2008; Papa & Peters, 2011, 2013; Roulstone, 1999; Woods & Marginson, 2004). This is an on-going issue, even though the IASB added a paragraph to IFRS 7 in 2010 explaining that qualitative descriptions and explanations are necessary for users to have a full understanding of the quantitative disclosures.

Transfers of financial assets

As shown in Figure 4.1, IFRS 7 requires ancillary disclosures where companies have transferred financial assets and have not obtained derecognition under IAS 39, or achieving derecognition, have retained some of the risks associated with the transferred asset. In the case of the former, companies are required to provide sufficient information to permit users to understand the nature of the transaction. In the case of the latter, the 2007/8 financial crisis highlighted issues with asset securitisations used to remove poorly performing assets from companies' balance sheets. Another technique used by the failed bank Lehman Brothers was the use of repurchase agreements (derivatives) to remove up to US$50 billion of risky assets, including other derivatives and securitisations, from their books for short periods around balance date (Jones, 2011). Effective from 2010, the IASB introduced substantial new disclosure requirements intended to prevent similar situations in the future.

Therefore, the consensus from studies on disclosure quality is that the technical requirements of IFRS 7 are met in most cases, but often in ways that are perfunctory and lack transparency. This coincides with a more general concern from regulators, standard setters, and the accounting profession that financial statement disclosures are growing in length, while decreasing in informativeness (ACCA, 2012; FRC, 2009, 2011; Hoogervorst, 2013; IASB, 2008a, 2008b; KPMG, 2011). The IASB has responded by inserting a chapter on presentation and disclosure in their exposure draft for the Conceptual Framework, with a request for companies to focus more on entity specific information and avoid “boilerplate” disclosures (IASB, 2015d para.7.18).

However, what is unknown is to what extent poor disclosure quality affects users. Despite identified deficiencies, do users still find the information provided under IFRS 7 useful? Research on this topic suggests sophisticated users may be willing to search through an annual report for the information they need (Durocher & Gendron, 2010; Thinggaard, 1996). Consistent with this possibility, Ryan (2012) believed that with the right motivation, information provided in the disclosures for derivatives can be successfully analysed.

4.2 IFRS 7 Usefulness Research

The main body of literature relating to IFRS 7 concerns the value-relevance or risk-relevance of particular items contained in the disclosures. Traditional value-relevance literature examines aspects of usefulness for equity investors. That is, tests of value-relevance extend knowledge regarding the relevance and reliability of accounting amounts through their reflection in equity values (Barth et al., 2001). Similarly, risk-relevance literature reveals the extent to which the market has used a particular piece of accounting information to price companies’ risk. This provides information about users’ expectations that the item will allow them to evaluate the consequences of future events for company performance (Ryan, 2012).

Archival market based research into the disclosures required by IFRS 7 predominantly focuses upon individual quantitative disclosures in the financial statements of banks and reports mixed results. For example, early findings that disclosures of VaR modelling were associated with measures of company value or measures of risk (Jorion, 2002; Lim & Tan, 2007; Liu, Ryan, & Tan, 2004) were contradicted in more recent work (Pérignon & Smith, 2010). Similarly, research into companies' use of fair values calculated under each of the three hierarchies of fair value suggests some relation between the degree of observability of the inputs used in the fair value calculation and share price or risk measure, but evidence is also inconsistent (Liao, Kang, Morris, & Tang, 2010; Riedl & Serafeim, 2011; Song, Thomas, & Yi, 2010). This led Ryan (2012, p. 316) to conclude that, "… risk disclosures in financial reports are risk-relevant but less so than one would expect given the high-volume of and strong economic bases for those disclosures."

Another way that research has approached the usefulness construct is by asking users about their views and preferences (Beattie & Pratt, 2002). Typically, these direct studies utilise survey questionnaires and interview based methods. Surveys of users are quite sparse (Johansen & Plenborg, 2013) and have tended to provide more information about investors than lenders (Beattie & Pratt, 2002). However, in one recent study, Johansen and Plenborg (2013) provided evidence on the usefulness of 24 mandatory disclosures, including IFRS 7, by surveying 288 users (private investors, professional investors, sell-side analysts, and bank analysts) and 89 companies (small, medium, large, and state-owned) to obtain their views. They identified that the IFRS 7 disclosures are highly demanded by all categories of user, that these are also among the items thought by companies to be most costly to prepare, and that users are comparatively less satisfied with these notes. These findings clearly point to a need to identify ways to increase satisfaction with the disclosures for users while considering the cost to preparers. There are differing opinions in the literature as to what would improve the disclosure of derivatives. For example, Johansen and Plenborg (2013) suggested that a reduction in the complexity of the notes required under IFRS 7 would make them simpler for preparers and, they hoped, more user-friendly. Others believe that complex transactions require more rigorous disclosure, not less (e.g. Ryan, 2012).

While some conclusions about the decision-usefulness of disclosures for derivatives can be inferred from archival literature, such as Ryan (2012), who found a less than expected degree of value-relevance or risk-relevance, archival research does not provide insight into the reasons underlying its findings. Other limitations of archival research include its emphasis upon the quantitative disclosure requirements of IFRS 7 and focus upon disclosures in the banking sector. More broadly, this type of research is unable to determine whether financial statements are the source of information used by the market, or whether other, undisclosed information might be more useful. Similarly, recent survey evidence from Johansen and Plenborg (2013) identified high user demand for derivatives disclosure coupled with comparatively low user satisfaction and pointed to a need for more research into why satisfaction is low, or how satisfaction could be increased. Acknowledging users' lack of advocacy during the standard setting process (Giner & Arce, 2012; Jorissen et al., 2012; Jorissen, Lybaert, Orens, & van der Tas, 2013; Larson, 2007), individual interviews may be more effective in eliciting users' views (Weetman, Davie, & Collins, 1996).

Both the structure of the IASB and its due process described in Section 2.2 provide opportunities for interested parties to participate in the standard setting process. This leads to claims that stakeholders lobby the IASB and leaves open the prospect of one or more private interests having undue influence over accounting standards that do not preference the needs of users. The following two sections discuss two strands of academic literature that examine the standard setting process. These are related to the third research question that asked whether the disclosure requirements of IFRS 7 are designed to meet the needs of users or preference the needs of another stakeholder group. The first strand of literature examines the participation of stakeholders during the IASB's public consultation on accounting standards. This literature analyses comment-letters written by stakeholders to meet its research objectives. The second strand is politically or theoretically motivated and focusses on less overt lobbying and paths to influence.

4.3 Lobbying Research

While there has been substantial research into lobbying activity directed at various national standard-setting regimes, research into lobbying of the IASB is a much more recent phenomenon. Due to the often necessary reliance placed upon publicly available information, lobbying literature has examined comment-letters submitted by stakeholders during public consultation and can be broadly classified into two strands. The first strand is research that increases knowledge of stakeholder engagement and participation. The second strand is research that increases knowledge of standard setters' responses to lobbying. With some overlap in individual studies, typical questions asked in each category are summarised in Figure 4.2.

Participation studies	**Influence studies**
• Stakeholder characteristics and diversity • Stakeholder reasons to lobby • Content or characteristics of stakeholder submissions	• Influence of stakeholders on standard setters • Motivation of standard setters to respond to lobbying efforts

Figure 4.2 Categories of lobbying literature and typical research objectives

Participation studies have shown that from the early days of the IASC to the present, overall stakeholder participation in the international standard setting process has increased as the IASB has become more important (Jorissen et al., 2013; Larson, 2007). The majority of comment letters are written by preparers, audit firms, and regulatory bodies (Chatham, Larson, & Vietze, 2010; Giner & Arce, 2012; Jorissen et al., 2012). Few letters are written by users and user participation may actually be decreasing (Jorissen et al., 2013). The lack of participation by users has been interpreted as a risk to the legitimacy of the IASB (Giner & Arce, 2012; Jorissen et al., 2012, 2013; Larson, 2007), as the provision of information that is useful to users is the objective of financial reporting (IASB, 2010a).

Participation studies have further identified geographic biases towards Anglo-Saxon countries in terms of the volume of comment letters (Jorissen et al., 2013; Orens, Jorissen, Lybaert, & Van Der Tas, 2011). As a natural consequence of the preponderance of comment letters from preparers and their representatives, a small body of research has focused upon preparers, as either the main objective or part of a wider study. Research into preparers has focussed on company size and timing of contributions (Jorissen et al., 2012), the institutional settings of the lobbyists' country of origin (Orens et al., 2011), or how company characteristics are associated with the views expressed in submissions (Katselas, Birt, & Kang, 2011).

Few studies have evaluated the influence of lobbyists on the IASC and IASB during public consultations on standard setting. Findings of influence have been mixed, with some (Cortese & Irvine, 2010; Kwok & Sharp, 2005), but not all (Bamber & McMeeking, 2015; Giner & Arce, 2012) identifying some degree of preparer influence over the standard setting process. Cortese and Irvine (2010) found that multinational corporations had captured standard setting for the extractive industry, while Kwok and Sharp (2005) concluded that the standard setter attempted to meet the needs of as many stakeholders as possible, while noting that changes to standards following public consultation were at the behest of preparers. Giner and Arce (2012) found a pluralistic process, as did Bamber and McMeeking (2015), although the latter observed the views of the large audit firms were downplayed by the standard setter. In taking account of the views of all stakeholders, the IASB avoids the "potential negative impact that any widely observable procedural bias resulting from excessive influence would have", thereby preserving "moral and cognitive legitimacy" (Bamber & McMeeking, 2015, p. 11). Earlier research into the IASC similarly found a standard setter seeking acceptance from its constituents and willing to compromise (Kenny & Larson, 1993; Larson & Brown, 2001). One interpretation of the influence research is that international standard setting is generally pluralistic, although preparers have significant influence.

While counting letters and identifying influence based upon changes made in standards is an accepted approach in the literature (Kenny & Larson, 1993; Kwok & Sharp, 2005; Saemann, 1995), it is also acknowledged as a somewhat unsatisfactory test (Giner & Arce, 2012; Kenny & Larson, 1993; Weetman et al., 1996). This is why researchers have combined analyses of comment letters with interviews with IASB board members (Kwok & Sharp, 2005) or with documentary evidence of IASB deliberations (Bamber & McMeeking, 2015). However, both of these approaches add an IASB perspective to the analysis. A further issue is that none of these studies collected data from exposure drafts issued after 2005, when international standards came into effect in many countries and over 100 countries subsequently adopted them (IASB, 2015f). This may have consequences for interpretations of the IASB's legitimating behaviour within the "complex and shifting interrelationships" of the international accounting arena (Hopwood, 1994, p. 245). Given mixed results, it is also possible that relative influence is context-specific and is not drawn out by single issue or single exposure draft studies (Weetman et al., 1996). Existing studies do not evaluate long-term influence and most do not take account of unseen influences.[14]

4.4 Political Influence Research

Influence may be acquired in ways other than public lobbying. This has led researchers to examine the relationships of influence at the IASB and other mechanisms through which influence is exercised in the standard setting process (Bengtsson, 2011). Describing the seminal work of Camfferman and Zeff (2007) on the history of the IASB as "at times … reading like a murder mystery, tracing tactical manoeuvring, horse-trading, and outright power play", Botzem and Quack (2009, p. 990) argued for recognition of the roles and motivations of the IASB's stakeholders. From the intensely political origins of international harmonisation (Camfferman & Zeff, 2007; Thorell & Whittington, 1994), to how the IASB has shaped and been shaped by the financialisation of the political economy (Arnold, 2009, 2012; Martinez-Diaz, 2005; Perry & Nölke, 2005, 2006), and the role of the private sector (Botzem & Quack, 2009; Hopwood, 1994; Perry & Nölke, 2005), it has been argued that the standard setting process is intensely political.

Some researchers have made a link between growth in world capital markets, increased financialisation of business (away from industrial forms of capital), and the involvement of large audit firms in this process (Arnold, 2009; Martinez-Diaz, 2005; Perry & Nölke, 2005; Suddaby et al., 2007). This perspective has tended to dominate political economy literature. The well-documented origins and continued reliance of the IASB on the accounting profession and close relationships with big business have contributed to concerns that standard setting has become dominated by the principle of expertise over that of

[14] An exception is the identification by Cortese and Irvine (2010) of a discrepancy between stakeholder lobbying and the outcome of standard setting for IFRS 6.

representativeness (Botzem & Quack, 2009; Hallström, 2004; Martinez-Diaz, 2005). An example is that although the IASB adds items to its agenda in response to what it believes are the needs of users (IASB, 2015k), discussion papers are drafted solely on the basis of analysis drawn from staff research and recommendations. While suggestions made by the IFRS Advisory Council, working groups, other standard-setters, and presentations from invited parties are recognised in this process, their role is purely consultative and the IASB's technical personnel remain in control (Botzem & Quack, 2009). This strengthens the principle of expertise and feeds into concerns about the influence of audit firms, as many of the IASB's personnel arrive from the global professional services firms. At the same time, audit firms provide staff to their client-firms (Suddaby et al., 2007) leading to a feedback-loop of shared norms, values, and beliefs (Botzem & Quack, 2009; Camfferman & Zeff, 2007; Power, 2009). In this way global audit firms exert their influence, both directly through the provision of money and expertise, and indirectly by controlling the discourse (Hopwood, 1994).

An alternative perspective is that the IASB is more strongly influenced by the vested interests of big business and the national governments and regulators that support them (Danjou & Walton, 2012; Zeff, 2002, 2007). Observations of changing patterns of influence since the 2007/8 financial crisis may serve to support the view of increased influence of European and other regulatory bodies at the expense of audit firms (Bengtsson, 2011; Burlaud & Colasse, 2011).

Whichever private interest is assumed to have the greatest influence on the standard setting process, it is generally agreed that although the IASB puts users at the forefront in its Conceptual Framework, it has little genuine contact with them (Durocher, Fortin, & Côté, 2007; Durocher & Gendron, 2010; Hopwood, 1994; Larson, 2007; Young, 2006). As

Hopwood (1994, p. 248) observed, “the voice of the user is almost invariably one that is referred to indirectly, often by the representatives of the audit industry who claim to be able to articulate the needs, interests and perspectives of the user community.”

The third research question requires an understanding of what users and other stakeholders find useful in financial disclosure, which led to sub-research question 3.1. Section 4.5 identifies the economic consequences of disclosure for users and other stakeholders. The identification of economic consequences led to expectations about the lobbying behaviour of stakeholders expressed as propositions tested in the second study.

4.5 The Interest Groups

The IASB identifies its stakeholders as accountants, financial analysts and other users of financial statements, the business community, stock exchanges, regulatory and legal authorities, academics and other interested individuals, and organisations from around the world (IASB, 2014b). Lobbying research categorises stakeholders as financial statement users, financial statement preparers, audit firms, and regulators. An additional category is added for academics, consultants, or others that may write comment letters (e.g. Giner & Arce, 2012; Kwok & Sharp, 2005). Three groups: users, preparers, and audit firms have a direct economic interest in the outcome of the standard setting process that should ultimately dictate their preferences (Zeff, 1978). In accordance with the economic theories of regulation outlined in Section 3.4, users are the intended beneficiaries of the regulation, while preparers and audit firms are the subjects of regulation. Economic theories predict that other stakeholders, such as regulators and the IASB, will tend to represent one or more of the three vested interests for whom the contents of an accounting standard has direct economic consequences (Zeff, 1978).

Prior research offers theories and some evidence about the disclosure preferences of each stakeholder category based upon their economic incentives.

4.5.1 Users

Users are the investors, lenders, and other creditors that rely upon the financial statements to make resource allocation decisions (IASB, 2010a). Financial statement disclosures reduce the private proprietary information of corporate preparers and lower information asymmetry (Healy & Palepu, 2001). Although all users consistently show a preference for financial statements and footnotes over other sources of information (ACCA, 2012; Beattie & Pratt, 2002; Berry & Robertson, 2006; Chandra, 1975; De Zoysa & Rudkin, 2010; Gassen & Schwedler, 2010; Hines, 1982; Johansen & Plenborg, 2013; Vergoossen, 1993) different categories of user may differ in terms of the disclosure characteristics they prefer. Private investors, for example, show a preference for summarised information (Beattie & Pratt, 2002; Johansen & Plenborg, 2013) and are more likely to be concerned about high volumes of disclosure and "information overload" (Beattie & Pratt, 2002, p. 74). However, private investors do not tend to contribute during the standard setting process (Georgiou, 2010).

In the IASB's public consultations on standard setting, users are sophisticated investors. They are the investment management and financial analyst industry groups that write comment letters and involve themselves in the standard setting process. Financial analysts place a high value on predictive or forward looking information (Beattie & Pratt, 2002; Johansen & Plenborg, 2013), including complex note disclosures that require judgement (Johansen & Plenborg, 2013). This is defined as a preference for complex information. Complex disclosures require estimation and judgement.

Analysts have a strong preference for quantitative information (Campbell & Slack, 2008; Papa & Peters, 2011) that is standardised and comparable (Papa & Peters, 2011, 2013). Analysts are not generally concerned by high volumes of detailed disclosure and want more granularities rather than less (Campbell & Slack, 2008). This is defined as a preference for uniformity. Uniform disclosures contain specific rule based requirements that reduce managerial choice and preference quantitative or tabular disclosures over qualitative or narrative disclosures.

Analysts are also interested in understanding management objectives and strategy, value-drivers, and detailed information on lines of business (Beattie & Pratt, 2002). Preparers and investors that are not owners might consider such information commercially sensitive; however, analysts and potential investors that are not owners value commercially sensitive information, as they do not bear the cost (Elliott & Jacobson, 1994). This is defined as a preference for commercially sensitive disclosure. Commercially sensitive disclosures are either future oriented, revealing future strategies and plans that have not yet occurred, or provide detailed operational information (Elliott & Jacobson, 1994). Commercially sensitive disclosures may be either uniform or complex disclosures.

As users, by definition, cannot demand information when needed, they will favour full disclosure including uniform, complex, and commercially sensitive disclosures that increase transparency. The proposition is:

P_1 Users will support new disclosures that increase transparency.

4.5.2 Preparers

Preparers are the mainly listed companies required to prepare accounts in accordance with international accounting standards. Positive accounting theory predicts that managers will lobby against new or increased disclosures that have high processing costs, as they reduce firm profit (Watts & Zimmerman, 1978). Processing costs include staff costs to gather and process information, staff training, systems development costs, and audit costs (Elliott & Jacobson, 1994). A number of factors affect the extent to which new disclosures will increase processing cost. Uniform disclosures increase processing costs, but individually do not have high processing costs. However, large volumes of uniform disclosure have a correspondingly high processing cost. Complex disclosures that require estimation and judgement by their nature have high processing costs. However, complex disclosures based upon information that is already gathered for management purposes do not have a high incremental processing cost (Elliott & Jacobson, 1994). Existing lobbying research supports the expectation that preparers will reject disclosures that increase processing costs (Elbannan & McKinley, 2006; Jorissen et al., 2012; Saemann, 1999). The proposition is:

P_2 Preparers will oppose disclosures that increase processing costs.

Managers will also lobby against commercially sensitive disclosures that create a competitive disadvantage (Beattie & Smith, 2012; Elliott & Jacobson, 1994). The costs of competitive disadvantage are ‘proprietary costs’. Commercially sensitive disclosures are either future oriented, revealing future strategies and plans that have not yet occurred, or provide detailed operational information (Elliott & Jacobson, 1994). Future oriented disclosures are expected to generate higher concerns about proprietary costs, as rivals have more time to react before the disclosed information affects the market (Berger, 2011). Competitive disadvantage may arise from the application of a disclosure standard when competitors are private companies not required to comply with international standards. Commercially sensitive disclosure may be either uniform or complex but are not narrative disclosures. Less prescriptive narrative disclosure requirements are more likely to give managers the discretion to avoid disclosing commercially sensitive information. The proposition is:

P_3 Preparers will oppose disclosures that may be commercially sensitive.

4.5.3 Audit firms

Audit firms are the large global and mid-tier professional services firms that write comment letters to the IASB. Although in principle audit firms act on behalf of the owners of the companies they audit, they have direct and indirect pecuniary interests in the outcome of the standard setting process. Little is known about the behaviour of audit firms in international standard setting and researchers have called for them to be subjected to analysis (Cooper & Robson, 2006; Humphrey & Loft, 2009; Jorissen et al., 2012).

Audit firms may lobby on behalf of their clients on accounting issues because their clients pay their fees. An alternative explanation is that the lobbying efforts of audit firms will often coincide with those of their clients because their incentives are aligned (Watts & Zimmerman, 1981, 1986). That is, an accounting change with a positive wealth effect on a client-firm would lead to a larger client and consequently higher audit fees. However, in some cases an audit firm may obtain a greater benefit from acting against the interests of its clients, such as when an accounting change leads to more work and incrementally higher audit fees (Watts & Zimmerman, 1981). Large audit firms may also value the longer term effect of increased disclosure in consolidating their business interests (Stigler, 1971). This occurs through the exclusion of smaller audit firms that are unable to compete in an increasingly specialised environment. There is some evidence that audit firms support increased disclosure (Puro, 1984).

Auditors are expected to favour increased disclosures that are uniform, as they lead to higher audit fees. Uniform disclosures are prescriptive and quantitative and reduce judgement. In requiring less judgement from managers to prepare them, uniform disclosures also require less judgement from auditors to audit them. Such disclosures can be standardised and checklists developed. Checklists enable junior staff to perform more of the audit work (McBarnet, 2001; McBarnet & Whelan, 1991). In this respect, the economic interests of the audit firms may partly coincide with the interests of those they are legally bound to represent, that is, the shareholders of the companies that they audit (users). The proposition is:

P_4 Audit firms will support disclosures that are uniform.

A caveat is that an auditor will only favour increased disclosure to the extent that they are able to pass the associated audit risk onto their client through their fees. As this is not always possible, auditors are more likely to align with their clients in lobbying against a change regarding disclosures that have a high risk of misstatement (Meier, Alam, & Pearson, 1993). The provision of some fair value estimates and forecasted information falls into this category of complex disclosures that increase audit risk and are not amenable to audit by checklist. In this respect, the economic interests of audit firms may partly coincide with the interests of their clients (preparers), as complex disclosures have high processing costs. The proposition is:

P_5 Audit firms will oppose disclosures that are complex.

4.5.4 Regulators

Regulators are national standard setters and regulatory agencies, as well as supranational bodies such as the European Financial Reporting Advisory Group (EFRAG) and the International Organization of Securities Commissions (IOSCO). Economic theories predict that a regulatory body will be motivated by goals such as job retention, securing and enhancing power, and personal wealth after the period of office-holding ends (Levine & Forrence, 1990). In most cases, this means regulators reflect the interests of the national or regional governments that back them. Individual governments, and by extension their national standard setters and regulatory bodies, will always intervene where accounting considerations might be expected to adversely impact their economic or social policies (Zeff, 1978, 2002). This means in most cases, regulators are expected to act in the interests of big business. An exception may occur when the stability of financial markets becomes more salient than business interests are. Regulators are expected to act where necessary to safeguard the integrity of capital markets, as this is also a goal of national governments and business in a global economy. In the latter case, regulators will evidence a preference for the user perspective of disclosure that increases transparency. There is some evidence of regulators adopting a user perspective (Giner & Arce, 2012). The proposition is:

P_6 Regulators will support the disclosure preferences of preparers.

4.6 Summary

This chapter positioned the present research within existing literature and justified the objective and research questions. Sections 4.1 and 4.2 supported the first two research questions. Section 4.1 demonstrated that disclosure quality research might have implications for the usefulness of information provided by companies under IFRS 7. In Section 4.2, archival research indicated mixed results regarding the value-relevance and risk-relevance of quantitative disclosures prepared under IFRS 7, but did not identify if other information might be more useful to users. Sections 4.3, 4.4, and 4.5 supported the third research question and sub-research question. Section 4.3 revealed that there is limited evidence based research into influence over international standard setting. In Section 4.4, regulatory capture was identified as a plausible reason for disclosures provided under IFRS 7 not being decision-useful. In Section 4.5, the interest groups that lobby the IASB and their preferences were identified using an economic incentives approach and existing literature. Chapter 5 introduces the theoretical perspective, including the assumptions about the nature of reality and knowledge that underpins the research methodology and methods described in Chapter 6.

CHAPTER 5 THEORETICAL PERSPECTIVE

Chapter 4 presented the literature that informs and supports this research. This chapter sets out the theoretical perspective that underpinned the conduct of the research. Section 5.1 discusses the ontology and epistemology that are underlying assumptions in the conduct of research. Section 5.2 describes the philosophy of Peircean pragmatism that provides a logical context for ontology, epistemology, methodology, and methods. Section 5.3 connects Peircean pragmatism to the present research.

5.1 Theoretical Perspective

A researcher's worldview is a basic belief system that guides them "not only in choices of method but in ontologically and epistemologically fundamental ways" (Guba & Lincoln, 1998, p. 95). A particular theoretical perspective must fit with the researcher's worldview, providing a logical context for ontology, epistemology, methodology, and methods (Gaffikin, 2008).

Ontology is concerned with the nature of reality. The extent to which a researcher believes that reality is real determines what they think they can know about "how things really are" and "how things really work" (Guba & Lincoln, 1998, p. 201). This research was conducted from a realist perspective. A realist ontology is often associated with an objectivist epistemology, although this does not have to be the case (Crotty, 1998). An epistemology is "a way of understanding and explaining how we know what we know" (Crotty, 1998, p. 3). An objectivist epistemology suggests that meaning is inherent in an object. That a tree "would be a tree, with that same meaning, whether anyone knew of its existence or not" (Crotty, 1998, p. 43). Alternatively, the constructionist epistemology adopted in this research accepts that “all knowledge, and therefore all meaningful reality as such, is contingent upon human practices” (Crotty, 1998, p. 42). For an epistemological constructionist, knowledge (or truth) is neither objective nor subjective, but is made by human beings (Crotty, 1998). On this understanding, there is no true or correct interpretation, only more or less useful interpretations (Crotty, 1998). As explained by Crotty (1998, p. 61), a critical mind-set can be consistent with a constructionist viewpoint, for example, “early exponents of American pragmatism - Charles Sanders Peirce, William James and John Dewey - were constructionist and critical.” This is consistent with research that considers the possibility of change. The realist ontology and constructionist epistemology of this research guided and constrained its methodology. Methodology is concerned with research design and method, how a researcher goes about “finding out whatever he or she believes can be known” (Guba & Lincoln, 1998, p. 201).

5.2 Peircean Pragmatism

The theoretical perspective of Peircean pragmatism reflects the views adopted in this thesis, and provides a logical context for ontology, epistemology, methodology, and methods. Table 5.1 compares Peircean pragmatism with other well-known theoretical perspectives.

Table 5.1 A comparison of theoretical perspectives

	Theoretical perspective			
	Positivism	**Pragmatism**	**Critical realism**	**Post-modernism**
Ontology	Realist	Realist	Realist	Idealist
Epistemology	Objectivist	Constructionist	Constructionist	Subjectivist

The American logician, statistician, and philosopher, Charles Sanders Peirce, developed his theory of pragmatism in the late 1860s together with William James and Chauncey Wright

(Misak, 2013b).[15] Pragmatism subsequently achieved prominence in the first half of the twentieth century with the work of William James, and later John Dewey, although they took pragmatism in directions different to the analytical approach of the principal founder, Peirce (Misak, 2013a). Perhaps as a result, many accounts "tend to reflect a popularised view of pragmatism rather than the careful nuances of its founders" (Gaffikin, 2008, p. 72). Accordingly, much of the material in this chapter is an analysis of primary sources, including public lectures, meeting notes, articles, and unpublished working papers progressively released by Peirce's beneficiary, Harvard University, through the 1930s-1950s as eight books of collected papers.

The Peircean pragmatism described in this chapter requires a rigorous empirical approach, while recognising that all knowledge is relative to human experience. With mental flexibility grounded in mathematics and logic, Peirce treads a middle path between the extremes of positivism and anti-positivism. Peircean pragmatism provides an alternative to critical realism for those that prefer an approach that while realist, constructionist, and critical, avoids complex ontological commitments. Pragmatism provides epistemological justification for research that contributes to practice.

5.2.1 Epistemology

Theory of meaning

Peirce published a set of six papers in Popular Science Monthly during the period from 1877-1878. Of these, his article, *How to Make our Ideas Clear* (Hartshorne & Weiss, 1931-1958a para.388-410), in which he set out his scientific theory of meaning, is usually taken to be the genesis of pragmatism (Misak, 2013a). In this article he explained not only how to be clear

[15] Chauncey Wright died in 1875 and his work exists only in fragments (Misak, 2013a).

about what is meant by a particular thought or idea, but also how to identify ideas that are worthy of effort. As action follows thought, he believed that time should not be wasted on thoughts that are ultimately meaningless; meaningless because there is no way of inquiring into them (Hartshorne & Weiss, 1931-1958a para.401). At the time Peirce was writing, it was assumed by most philosophers that the meaning of an idea was clear if it could be defined analytically and identified in operation (Hartshorne & Weiss, 1931-1958b para.481).[16] Peirce extended this requirement in his *pragmatic maxim*,

> Consider what effects, that might conceivably have practical bearings, we conceive the object of our conception to have. Then our conception of these effects is the whole of our conception of the object (Hartshorne & Weiss, 1931-1958a para.402).

The pragmatic maxim therefore adds that a concept is understood by exploring its connections with the practical world, and any idea that does not or cannot have a practical effect is without scientific meaning (Hartshorne & Weiss, 1931-1958a para.401). Unlike the logical positivists, Peirce's criterion of 'effect' is not limited to the five senses, but includes anything that does or could impinge upon cognition, either directly or indirectly (Burks, 1931-1958 para.623). This has implications for methodology.

Theory of knowledge

In his article, *The Fixation of Belief* (Hartshorne & Weiss, 1931-1958a para.358-387), Peirce set out a conception of inquiry that led to his account of truth. Doubt, Peirce believed, makes people uncertain about how to think or act. Not knowing how to think or act causes anxiety and drives people to find resolution by making inquiries; therefore, the purpose of inquiry is

[16] This is the Aristotelian concept of induction: that in order to know about something, it is necessary to observe and examine instances of it (Gaffikin, 2008).

to settle genuine doubts that paralyse action (Hartshorne & Weiss, 1931-1958a para.375). The settlement of doubt becomes the natural end of inquiry and eliminates the need for absolute proof (Hartshorne & Weiss, 1931-1958a para.375). This is the *doubt-belief model of inquiry*:

> We have in our various inquiries and deliberations a multiplicity of local aims - empirical adequacy, coherence with other beliefs, simplicity, explanatory power, getting a reliable guide to action, fruitfulness for other research, greater understanding of others, increased maturity, and the like. When we say that we aim at the truth, what we mean is that, were a belief really to satisfy all of our local aims in inquiry, then that belief would be true (Misak, 2013a, p. 63).

Belief is the end of inquiry because Peirce held to the essentially Kantian position that "all our knowledge is, and forever must be, relative to human experience and to the nature of the human mind" (Hartshorne & Weiss, 1931-1958a para.95). However, Peirce rejected scepticism, strongly defending the existence of an in-principle ultimate truth.

> Nothing can be more completely false than that we can experience only our own ideas. That is indeed without exaggeration the very epitome of *all* falsity. Our knowledge of things in themselves is entirely *relative,* it is true; but all experience and all knowledge is knowledge of that which is, independently of being represented (Hartshorne & Weiss, 1931-1958a para.95: emphasis in original).

Philosopher Clarence Lewis held views similar to those of Peirce.[17] To those that would argue knowledge and reality are entirely constructions of the mind and cannot be known, Lewis explained that to the contrary, "relativity is not incompatible with, but *requires* an independent character in what is thus relative" (Lewis, 1956 [1929], p. 172 emphasis in original). Conversely, against the position that there is a direct line between observation and truth, Lewis observed that "we cannot both of us see reality as it is when we do not see it alike" (Lewis, 1956 [1929], p. 166). Pragmatism therefore draws a distinction between immediate data, or that which is simply observed, and belief about or interpretation of that data, arguing that sensory observation is not knowledge and cannot justify belief (Lewis, 1956 [1929], p. 54).

A constructionist approach to knowledge leads to fallibilism, where the results of all inquiry are open to question and revision as indicated by the evidence available at any given time. Inquiry, Peirce said, "is not standing upon the bedrock of fact. It is walking upon a bog, and can only say, this ground seems to hold for the present. Here I will stay till it begins to give way" (Hartshorne & Weiss, 1931-1958a para.589). Any seeker of knowledge must always be open to criticism, willing to change their mind and understand that what they now believe to be true could change in the future.

Applying fallibilism to the concept of truth, it follows that while the purpose of inquiry is to move closer to truth, actual truth exists notionally (Hartshorne & Weiss, 1931-1958a para.565). In the mean time, beliefs may be held if they seem plausible to the community of inquirers (Hartshorne & Weiss, 1931-1958a para.265), and in the absence of evidence to the

[17] Clarence Irving Lewis, like Peirce, was a logician, and as a contemporary of John Dewey, had studied under William James as an undergraduate. When Lewis first arrived at Harvard as a faculty member he obtained the collected manuscripts that had been left to Harvard in a state of disarray by Peirce's widow, and so was able to benefit from access to Peirce's significant body of unpublished work (Misak, 2013a).

contrary, may be operated upon as if they are true (Hartshorne & Weiss, 1931-1958a para.38).

Methodological approach

Peirce was an empiricist. He argued comprehensively in his article *The Fixation of Belief* (Hartshorne & Weiss, 1931-1958a para.358-387) that this is the only method by which people can hope to obtain evidence not affected by their own thinking, and is the only method that will eventually allow everyone to reach the same conclusion based upon an accumulated evidence of experience (Hartshorne & Weiss, 1931-1958a para.384). Peirce wrote of the experimental method, however, he did not understand 'experiment' in the narrow sense of manipulating variables in a laboratory, and described what might be called an experimental mind-set that could be applied in any discipline (Hartshorne & Weiss, 1931-1958a para.168).[18] The central theme from Peirce's writings on the subject of scientific method is best encapsulated by his injunction to "only proceed from tangible premises which can be subjected to careful scrutiny, and to trust rather to the multitude and variety of its arguments than to the conclusiveness of any one" (Hartshorne & Weiss, 1931-1958a para.265). A rigorous approach together with replication logic and examination from different perspectives and world-views is the key to understanding the nature of evidence that leads to justified belief.[19]

In terms of what constitutes evidence, Peirce rejected positivists' closed system of knowledge, making clear that evidence may "come from any kind of cognition, virtual, symbolic or whatever it might be" (Hartshorne & Weiss, 1931-1958a para.181). Peirce

[18] For example, Peirce explained how his approach could be applied to establishing the truth or otherwise of claims made in ancient documents (Burks, 1931-1958 paras.162-255).

[19] This is similar to the concept of critical multiplism associated with post positivism (e.g. Letourneau & Allen, 1999; Shadish, 1993).

specifically accepted mathematical (Burks, 1931-1958 para.186) and diagrammatic proofs (Hartshorne & Weiss, 1931-1958a para.162), and did not reject the scientific nature of subjects such as cosmology and physics, or what he referred to as the normative sciences: logic, ethics, and aesthetics (Hartshorne & Weiss, 1931-1958a para.39).

Causation is also important to pragmatism. One of Peirce's contributions to logic was his identification of a third mode of reasoning, in addition to deduction and induction (Misak, 2013a). Peirce called his third kind of reasoning *abductive inference*. Abduction is a fundamentally creative and ampliative process, and it is only through abduction that new ideas can be introduced into a body of belief (Hartshorne & Weiss, 1931-1958a para.171).

> The abductive suggestion comes to us in a flash. It is an act of *insight*, although of extremely fallible insight. It is true that the different elements of the hypothesis were in our mind before; but it is the idea of putting together what we had never before dreamed of putting together which flashes the new suggestion before our contemplation (Hartshorne & Weiss, 1931-1958a para.181 emphasis in original).

That is, new theories are developed through the creative or intuitive application of observations to the background body of knowledge and beliefs (regulative assumptions). Research begins with a theory (hypothesis) formed from the deduction of the practical effects that might be observed if that theory were true or false. Those practical effects are then observed to see how closely they agree with the theory, followed by abduction and a return to theorising (Hartshorne & Weiss, 1931-1958a para.170).

Peircean pragmatism is also associated with a critical mind-set.[20] That Peirce was seeking a critical philosophy is evidenced by his insistence that "pragmatism is not a *Weltanschauung* but is a method of reflexion having for its purpose to render ideas clear" (Hartshorne & Weiss, 1931-1958a para.13 emphasis in original). As Crotty (1998, p. 218) explained, "*Weltanschauung* means 'worldview'; that is, the way one understands the world to be. For the most part, this is an implicit understanding and, as Peirce is suggesting, not a critical process."

5.2.2 The nature of reality

Pierce was dismissive of philosophical arguments concerning metaphysics, and particularly the ontological debate with an argument based on "one word being defined by other words, and then by still others, without any real conception ever being reached" (Hartshorne & Weiss, 1931-1958a para.423). Like many of his contemporaries, he focused on epistemology and largely left ontology and its close relation theology alone (Misak, 2013a). On the nature and existence of reality, his views were a logical extension of his detailed epistemology. Peirce believed that people must at least assume that there is a reality, for without it people would be unable to think, know, and act (Misak, 2013a). A belief in reality is prerequisite to a belief in the scientific method, and he was scathing of those who claimed to doubt the existence of reality, accusing them of self-deception, "let us not pretend to doubt in philosophy what we do not doubt in our hearts" (Hartshorne & Weiss, 1931-1958a para.265). He argued that if nothing were real, doubt would not be a source of dissatisfaction, and that an instinctive belief in reality "is one which every mind admits" (Hartshorne & Weiss, 1931-1958a para.384).

[20] Critical research recognises that knowledge is socially constructed. All critical research must therefore include a self-reflexive or reflective component (Carspecken, 2008).

For Peirce, reality is what does not change when it is observed. It is what impinges upon us and constrains us (Misak, 2013a). Or, as Lewis explained, the fountain pen held in his hand would no doubt be perceived differently by an infant, but its essential character would remain unchanged, whoever held it (Lewis, 1956 [1929]). This separates Peircean pragmatism from the later pragmatism of James and Dewey, who appeared to share the belief that nothing stands, apart from the interpretation of it (Misak, 2013a).

5.3 Implications for Research

How a piece of research will be carried out and analysed is influenced by both the philosophical stance underpinning the research (Carson et al., 2001; Crotty, 1998; Guba & Lincoln, 1998), as well as questions of methodological fit (Edmondson & McManus, 2007). The realist approach of Peircean pragmatism is suited to research that answers the call for accounting research more closely aligned with the needs of practice (Arnold, 2009; Bricker & Previts, 1990; Carlin, 2011; Fülbier et al., 2009; Granof & Zeff, 2008; Holthausen & Watts, 2001; Leisenring & Johnson, 1994; Schipper, 1994; Stevenson, 2011; Tilt, 2010) while pragmatism's constructionist epistemology is suited to the research of a complex issue. Both qualitative and quantitative research is possible in this paradigm. However, qualitative research is suited to answering *how* and *why* questions concerning complex social phenomena in an exploratory setting (Edmondson & McManus, 2007). A qualitative approach was therefore the best fit for the present research.

5.4 Summary

This chapter introduced the theoretical perspective that informed the research. The pragmatism of Charles Sanders Peirce is ontologically realist and epistemologically constructionist. It supports an empirical approach. Chapter 6 describes the research methods utilised in this thesis.

CHAPTER 6 RESEARCH METHODS

Chapter 5 introduced the pragmatism of Charles Sanders Peirce, which provided the theoretical perspective used in the research. The perspective is ontologically realist and epistemologically constructivist. This chapter sets out the research methods that answer the research questions in Section 1.4. Section 6.1 shows how the two studies answer the research questions and together meet the research objective. The research methods for the two studies are then explained in detail in Sections 6.2 and 6.3.

6.1 Overview

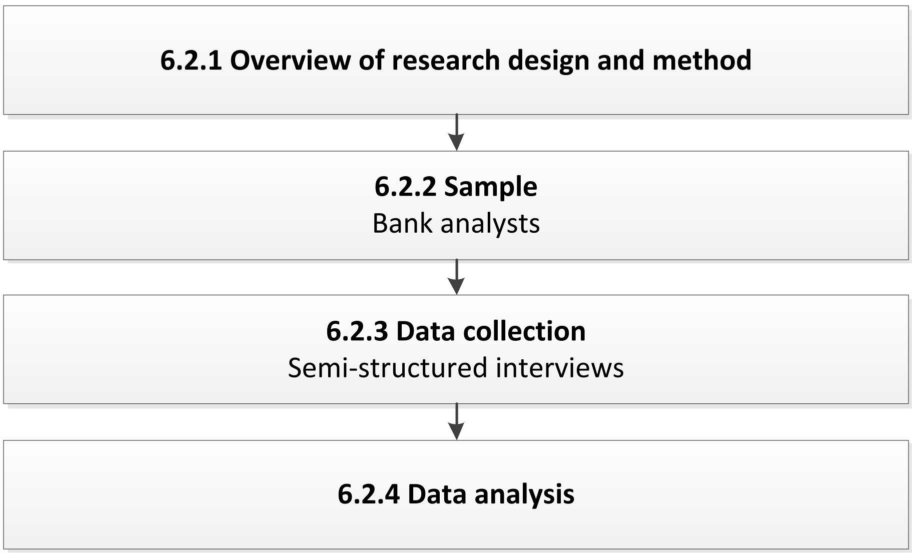
The objective of this research was to explore whether the derivatives disclosures required by IFRS 7 provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons.

Academic and practitioner literature discussed in Chapter 4 identified possible reasons for why the disclosures provided under IFRS 7 may not be useful to users and led to the research questions. First, there is evidence that companies implement the disclosure requirements for derivatives in a perfunctory and boilerplate way, although the extent to which financial statement users are adversely affected is unknown. Similarly, archival research provides mixed evidence regarding the value-relevance or risk-relevance of quantitative disclosures required under IFRS 7, but does not evaluate the qualitative risk management disclosures, without which the quantitative disclosures lack context. Archival research also does not evaluate whether a different disclosure would be more relevant to users than what is there. The first two research questions addressed these limitations through the first study (Section 6.2) that comprised in-depth interviews with bank analysts.

A different strand of literature provided a different perspective, suggesting that the disclosures for derivatives might not be decision-useful if IFRS 7 was not designed with users in mind. This would be the case if the standard setter had been 'captured' by one or more of its other stakeholders, as predicted by economic theories of regulation. This possibility led to the third research question and sub-research question, which were answered through the second study (Section 6.3) that comprised a content analysis of IFRS 7 and related documents.

6.2 Study One - Research Design and Method[21]

This section presents the research design and method for the first study, which comprised in-depth interviews with bank analysts.



6.2.1 Overview of research design and method

The aim of the first study was the same as the overarching research objective: To explore whether the derivatives disclosures required by IFRS 7 provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons. The first

[21] This section contains material published in Bean and Irvine (2015).

research question asked whether the disclosures for derivatives made under IFRS 7 fulfil their stated purpose in meeting the decision-making needs of users. To the extent that users found these disclosures less than useful, they were asked for reasons. The first research question therefore limited users' responses to what is in IFRS 7, including how companies apply the disclosure requirements in their annual reports. The second research question asked whether different disclosures might improve usefulness, which is concerned with the design of IFRS 7. The research questions were:

RQ1 Do the disclosures for derivatives made under IFRS 7 fulfil their purpose by meeting the decision making needs of users, and if not, why not?

RQ2 To the extent that the disclosures for derivatives required by IFRS 7 are not useful, what disclosures would be more useful?

Sixteen analysts from Australia's four largest banks were interviewed. Semi-structured interviews were recorded and transcribed, then coded based upon the responses of the analysts. Through the identification of similar or related comments, codes were refined, categories and sub-categories emerged, and the common views of the analysts were revealed.

6.2.2 Sample

The Conceptual Framework recognises that the primary users of financial information are investors, lenders, and other creditors (IASB, 2010a). Sophisticated users were selected for this phase of the research, as derivatives are complex and the intention was to understand whether the disclosures are capable of being useful, rather than whether they are used.[22] Acknowledging evidence of poor disclosure quality, research on this topic suggested

[22] The population of experts includes institutional investors and fund managers (buy-side analysts), equity analysts and brokers (sell-side analysts) and banks and ratings agencies (credit-side analysts).

sophisticated users are willing to search through an annual report for the information they need (Durocher & Gendron, 2010; Thinggaard, 1996).

This study used semi-structured interviews with 16 analysts from Australia's four largest banks.[23] Given these banks' market dominance, it was expected that the majority of listed and large private companies that prepare general-purpose financial reports have relationships with them. Although the sample was Australian, the research objective was not limited to Australia. Research into disclosure quality under international standards has investigated the relationship between countries' institutions and financial reporting outcomes, finding that disclosure quality is significantly influenced by economic and institutional frameworks (Leuz & Wysocki, 2008). Although Australia is much smaller than the major capital markets of the UK and the US, it fully converged with IFRS in 2005, its accounting is sophisticated, its institutions are advanced, and its larger companies make significant use of derivatives (Heaney & Winata, 2005).

Very little is known about the specific disclosure preferences of bank lenders (Armstrong et al., 2010), although their observations are particularly informative for this research as they place a strong emphasis on risk and risk management (Armstrong et al., 2010; Kothari et al., 2010). The bank analysts interviewed were also knowledgeable about derivatives and financial statement disclosures. Lenders want to know if a company will be able to meet its future obligations with regard to principal and interest repayments, or in the worst case, liquidation of collateral (AICPA, 1994; Kothari et al., 2010). Lenders are therefore less interested in valuation than investors are. However, informational requirements of both

[23] The Australian banking sector is dominated by four banks that also comprise four of Australia's top five listed companies by market capitalisation: Commonwealth Bank of Australia (A$145 billion), Westpac Banking Corporation (A$111 billion), Australia and New Zealand Banking Group (A$95 billion), and National Australia Bank (A$89 billion) (ASX 2015).

investors and lenders remain similar across many dimensions (Kothari et al., 2010), and insights offered by the analysts interviewed in this research extend the existing literature on the usefulness of IFRS 7 disclosures. To the extent that the sampling frame is not representative of the population of all users, there will be sampling frame bias.

The analysts were recruited using industry contacts. According to Patton (2002), all qualitative sampling is purposeful and its aim is to select cases that provide a rich source of information for the study. The use of industry contacts is a form of snowball sampling and is a useful way to pursue purposive sampling in situations where there are no lists or other obvious sources for locating members of the population of interest (Strauss & Corbin, 1990). Snowball sampling can also be helpful in accessing the elite where some degree of trust is required (Atkinson & Flint, 2004) and is an accepted method in exploratory research (Arksey & Knight, 1999). Drawing the sample across four banks mitigated the risk inherent in this sampling method of capturing a biased subset of the population of potential participants. Although generalising to the population was not possible, the selection of a sample that allowed for the subject to be viewed from different possible perspectives has the effect of increasing validity (Arksey & Knight, 1999; Shenton, 2004).

The analysts in this study assessed risk, either incidental to granting credit (credit analyst), or to the provision of risk advisory services for existing clients of their bank (risk advisor). All confirmed they had clients who used derivatives and, for both categories, the majority were actively involved in recommending derivatives to clients, either to mitigate risk prior to the granting of credit, or as part of advising clients on financial risk management. In either case, the analysts' roles were to maximise their bank's return on capital by providing independent credit analysis on the companies and industries to which the bank has exposure. For this research, both types of analyst confirmed they used their clients' audited annual reports when making their initial assessments of risk.

Table 6.1 summarises the characteristics of the analysts interviewed in this study. To maintain confidentiality, information on the banks or branches associated with individuals is not tabulated. Analyst experience ranged from four to over 30 years, with 11 having greater than 10 years' experience. Each analyst was allocated a number between one and 16 with a prefix: *A* for analyst or *SA* for senior analyst, which denotes greater than 10 years' experience. As the analysts were from small teams within the banks, there was little sector concentration evident in the sample, although their clients excluded other banks.

Table 6.1 Participant profiles

Interview designation	Years of employment	Role in Bank	Sector/s
A1	5-9	Credit analyst	Telecommunications
A2	5-9	Credit analyst	Mining and mining services
SA3	20-24	Credit analyst	Government, education, telecommunications
SA4	20-24	Credit analyst	All sectors
SA5	20-24	Credit analyst	All sectors
SA6	20-24	Credit analyst	All sectors
SA7	25-29	Credit analyst	Financial services (ex-banks) and government
A8	<5	Risk advisor	Financial services (ex-banks)
A9	<5	Risk advisor	All sectors
A10	5-9	Risk advisor	All sectors
SA11	10-14	Risk advisor	All sectors
SA12	10-14	Risk advisor	All sectors
SA13	15-19	Risk advisor	All sectors
SA14	15-19	Risk advisor	Engineering and mining services
SA15	15-19	Risk advisor	All sectors
SA16	30-34	Risk advisor	Financial services (ex-banks)

Note. Years of employment denotes years in the workplace, which is not the same as years in current role. A = analyst, SA = senior analyst with greater than 10 years of experience.

6.2.3 Data collection

An ethical clearance application to conduct interviews was submitted to the QUT Ethics Committee in December 2012. Approval was issued on 21 January 2013 and has been renewed until 21 January 2016, with approval number 1300000030. All QUT policy guidelines were adhered to and followed, and this information was included in all correspondence with the analysts.

For interviewing experts, semi-structured interviews most closely mimic how they conduct meetings within their professional organisations, and thus are a recommended format (Bogner, Littig, & Menz, 2009; Kolb, 2008). Semi-structured interviews also allow research questions to be asked, while not limiting the subjects' own reflections on the research question. All interviews were conducted either face-to-face or by telephone during January, February, and July of 2013 and were recorded. Interviews lasted between 30 and 45 minutes. The interview guide is in Appendix B. Information about the background of the analysts was first obtained. The first interview question then addressed the first research question and followed the tradition of evaluating the usefulness of accounting standards against their own stated objectives (Schipper, 2007). The focus therefore, was on how, and to what extent, the objectives of the disclosures in both the Conceptual Framework (IASB, 2010a para.OB2) and IFRS 7 (IASB, 2005 para.1) were met in the annual reports the analysts evaluated. Aligned with the second research question, the second interview question asked the analysts if they had any suggestions for improvement to the requirements of IFRS 7. Analysts were asked to consider their own informational needs, but be constrained by what, in their opinion, could reasonably be included in an annual report.

Semi-structured interviews are susceptible to low reliability, as questions are not consistently asked and there is a risk of interviewer bias (Gray, 2009). An unobtrusive attitude was therefore adopted throughout the interviews, clarifying the requirements of the accounting standard where necessary, but allowing the analysts to respond to the questions on their own terms and to raise and discuss issues that were most important to them. The initial interview strategy was adapted when necessary to explore emerging categories (Mason, 2002). New categories ceased to emerge after approximately 12 of the 16 interviews, indicating data saturation or informational redundancy, with little to be gained from additional interviews (Lincoln & Guba, 1994). This seemed reasonable given the relatively homogeneous characteristics of the analysts, and is consistent with evidence that minimum sample sizes for this kind of research fall somewhere between eight and 12 (Arksey & Knight, 1999; Onwuegbuzie & Collins, 2007).

The most likely risks to the validity of these interviews were social desirability bias, the risk of the analyst not having an opinion, and the risk of contamination (Corbetta, 2003). That the analysts were experts speaking to their area of expertise tended to reduce these risks. As analysts were interviewed from four different banks and three different cities, the likelihood of significant contamination caused by analysts discussing the research with each other was low.

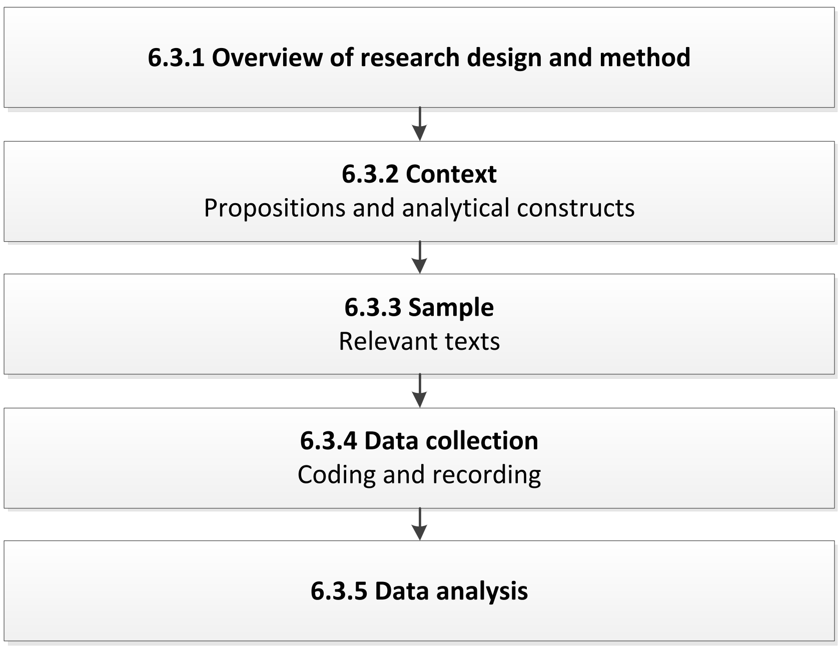
6.2.4 Data analysis

Seven interviews conducted during January and February of 2013 formed the basis of a pro-forma codebook, developed ex post, based upon the responses of the analysts. There was no ex ante theorising in this study, as the aim was to obtain the views of the analysts, not the views of the researcher. Coding was systematic, with a code initially created for each observation. Through the identification of similar or related comments, codes were refined and categories and sub-categories emerged. This preliminary data, grouped by category, was then displayed on a spread-sheet that aided the identification of relationships between the categories, leading to a return to the data and the codes in an iterative process (Miles & Huberman, 1994). In establishing these relationships, a search for rival explanations and negative cases was undertaken (Patton, 2002). The first seven interviews were transcribed by hand and a professional transcription service transcribed the second tranche of nine interviews. At this time, the pro-forma codebook and all interview transcripts were uploaded into NVivo, a software program designed to manage and analyse non-numerical, unstructured data. The manual process described above was repeated using the software, which served to improve the reliability of the coding (Durocher et al., 2007; Krippendorff, 2013).

Yin (2009) recommended the creation of a case database and the clear provision of a chain of evidence, sometimes referred to as an audit trail (Shenton, 2004). The chain of evidence provides assurance that the evidence originally collected connects with what is in the final report. In the opposite direction, it provides assurance that no original evidence has been lost through carelessness or bias. Yin's (2009) recommendation was followed and a cross-referenced 'audit file' was created. An experienced academic colleague reviewed the audit file, and verified the data, coding, and conclusions of the analysis on a sample basis.

6.3 Study Two - Research Design and Method

This section presents the research design and method for the second study, which comprised a content analysis of IFRS 7 and related documents.



6.3.1 Overview of research design and method

The aim of the second study was to explore usefulness from the perspective of the design of IFRS 7. That is, whether IFRS 7 is designed to meet the needs of users and should therefore be expected to provide decision-useful information. The research question was:

RQ3 Is IFRS 7 designed to meet the needs of users, or does it preference the needs of other stakeholder groups?

In order to answer the third research question, it was necessary to identify the information needs of users and other stakeholder groups that may have influenced or captured the standard setting process. Accordingly, a sub-research question was added to support question 3:

SRQ3.1 What disclosure characteristics do different stakeholder groups prefer?

The third research question and sub-research question were answered through a content analysis of documents. These documents were IAS 32, IFRS 7, four exposure drafts, and related stakeholder comment letters, covering the ten-year period from 2004 to 2014.

6.3.2 Context

Documents acquire their significance in the context of their use by the content analyst (Krippendorff, 2013). Therefore, the context is what connects the contents of the documents selected for analysis to possible answers to the research question. This research followed the analytical methods of Saemann (1999), who used what was known about the preferences of stakeholders in the United States standard setting process to infer influence from the characteristics of changes made to accounting standards. Therefore, what is currently known about the preferences of stakeholders and the characteristics of disclosure items provides the context for this research.

Propositions and analytical constructs

Although the interests of stakeholders may vary on particular issues, three groups: users, preparers, and audit firms have a direct economic interest in the outcome of the standard setting process that should ultimately dictate their preferences. Other stakeholders are expected to support one of more of these vested interests (Saemann, 1999).

Section 4.5 identified three disclosure characteristics expected to provoke lobbying activity from stakeholders due to their economic effect. The three disclosure characteristics were uniform disclosure, complex disclosure, and commercially sensitive disclosure. Each of the three disclosure characteristics is an *analytical construct* defined for use in the analysis. Uniform disclosures are quantitative and contain specific rules based requirements that reduce managerial choice (prescriptive). Complex disclosures are also prescriptive and quantitative, but involve estimation or judgement. Complex disclosures are usually future oriented. Commercially sensitive disclosures are future oriented, revealing future strategies and plans that have not yet occurred (complex), or provide detailed operational information (uniform). Commercially sensitive disclosures may be either complex or uniform disclosures, but are not narrative disclosures.

Six propositions were developed in Section 4.5 using the analytical constructs individually and in combination that described the expected lobbying of each stakeholder on proposed disclosures with those characteristics. The propositions were:

P_1 Users will support new disclosures that increase transparency.

P_2 Preparers will oppose disclosures that increase processing costs.

P_3 Preparers will oppose disclosures that may be commercially sensitive.

P_4 Audit firms will support increases in disclosures that are uniform.

P_5 Auditors will oppose disclosures that are complex.

P_6 Regulators will support the disclosure preferences of preparers.

Table 6.2 summarises the propositions for each stakeholder category by analytical construct.

Table 6.2 Summary of propositions by analytical construct

Full disclosure	Users	Preparers	Audit firms	Regulators
Uniform disclosure	Support	Oppose	Support	Oppose
Complex disclosure	Support	Oppose	Oppose	Oppose
Commercially sensitive disclosure	Support	Oppose	Support [a]	Oppose

[a] Audit firms have no in principle opposition to commercially sensitive disclosure, but will oppose if it is a complex disclosure.

Section 6.3.5 explains how the analytical constructs and propositions were used at each stage of the analysis.

6.3.3 Sample

In content analyses, a document is relevant if it provides meaningful evidence linking the context (propositions and analytical constructs) with answers to the research question (Krippendorff, 2013). The documents should therefore provide information about the disclosure characteristics of IFRS 7, changes to those characteristics, and the disclosure preferences of stakeholder groups. The documents selected were IAS 32, IFRS 7, four exposure drafts, and comment letters written by stakeholders during public consultation on the exposure drafts.

The period of analysis was the ten year period from 2004 to 2014. As explained in Section 2.3, a new disclosure standard for financial instruments was exposed for public comment in 2004, which led to the issue of IFRS 7 in 2005. Following the 2007/8 financial crisis, two exposure drafts were issued that had implications for the disclosure of derivatives. Then, in late 2010, changes proposed for hedge accounting had significant flow-on effects for the disclosure requirements. The response of stakeholders to these four exposure drafts provided sufficient evidence of their lobbying behaviour and their influence on the design of IFRS 7 in respect to derivatives. Appendix A shows all amendments to IFRS 7 from 2004 to 2014 and highlights the four exposure drafts selected for this study. All exposure drafts that substantially affected the disclosure of derivatives were selected.

When the IASB issues an exposure draft it invites the public to make written comment on matters proposed in the draft. The invitation is presented as a series of questions for stakeholders to answer. In the four exposure drafts identified for this research, each question was assessed for its applicability to the disclosure of derivatives transactions and for its ability to provide evidence of stakeholder preferences on the analytical constructs. Accordingly, questions about how items are classified, mandatory guidance and proposed effective dates were not selected. All other questions identified as relevant to derivatives were included in the analysis. Comment letters for each exposure draft were obtained from the IASB. Duplicates and letters incorrectly filed by the IASB were not counted in the sample. Table 6.3 shows the documents that comprise the sample and the wording of the questions selected from each exposure draft.

The sample comprised proposals by the IASB that substantively amended the disclosures relevant to derivatives. The relevant disclosures were identified and explained in Section 4.1. There was a risk that disclosures identified as relevant to derivatives were also relevant to other financial instruments. Letters from stakeholders concerning these disclosures may therefore not be in relation to derivatives. That there was no way to reliably identify and remove such respondents from the sample is a limitation. However, such a stakeholder is also arguing for an outcome that will affect companies that disclose in relation to their derivatives.

Table 6.3 Sample for document analysis

Date [a]	Document	Questions [b]
March 2004	IAS 32 Financial Instruments: Disclosure and Presentation	Questions 3: Is the proposed disclosure of a sensitivity analysis practicable for all entities? If not, why not?
July 2004	Exposure Draft ED 7 Financial Instruments: Disclosures	Question 6: Do you agree that the disclosures proposed by the draft IFRS should be part of the financial statements? If not, why not?
	Comment letters (99 letters)	
August 2005	IFRS 7 Financial Instruments: Disclosures issued	
October 2008	Exposure draft ED/2008/10 Improving disclosures about financial instruments	Questions 3(a): Do you agree with the proposals in paragraph 27B to require expanded disclosures about the fair value measurements recognised in the statement of financial position? If not, why? Question 4: Do you agree with the proposal in paragraph 39(a) to require entities to disclose a maturity analysis for derivative financial liabilities based on how the entity manages the liquidity risk associated with such instruments? If not, why?
	Comment letters (88 letters)	
March 2009	Improving Disclosures about Financial Instruments (Amendments to IFRS 7) issued	
April 2009	Exposure draft ED/2009/3 Derecognition	Question 11: Do you agree with the proposed amendments to IFRS 7? If not, why?
	Comment letters (114 letters)	
October 2010	Disclosures – Transfers of Financial Assets (Amendments to IFRS 7) issued	
December 2010	Exposure draft ED/2010/13 Hedge Accounting	Question 13(a): Do you agree with the proposed disclosure requirements? Why or why not? Question 13(b): What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?
	Comment letters (216 letters)	
November 2013	IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) issued	

Note. This table identifies the documents that comprise the sample for the second study. [a] Date is the date the document was issued. [b] Questions show the exact wording of questions in the respective exposure drafts selected for analysis.

6.3.4 Data collection

Accounting standards and exposure drafts

Tables were prepared to compare the applicable disclosure standard (IAS 32 or IFRS 7) before each exposure draft, the proposed changes to disclosure in each exposure draft, and the disclosure standard after amendments from each exposure draft. Disclosure items were identified at the lowest level the IASB describes in an exposure draft or standard, a sub-paragraph. Each change proposed and/or made to IFRS 7 over the ten-year period was coded in accordance with the three analytical constructs, as complex, uniform or commercially sensitive. No attempt was made to weight individual disclosure items. Tables are provided in the appendices as follows:

1. Appendix C tabulates the relevant requirements of IAS 32 before ED 7 Disclosures, the changes proposed in ED7, and the requirements of IFRS 7 immediately after amendments resulting from ED7.
2. Appendix D tabulates the relevant requirements of IFRS 7 before ED/2008/10 Improving Disclosures about Financial Instruments, the changes proposed in ED/2008/10, and the requirements of IFRS 7 immediately after amendments resulting from ED/2008/10.
3. Appendix E tabulates the relevant requirements of IFRS 7 before ED/2009/3 Derecognition, the changes proposed in ED/2009/3, and the requirements of IFRS 7 immediately after amendments resulting from ED/2009/3.
4. Appendix F tabulates the relevant requirements of IFRS 7 before ED/2010/13 Hedge Accounting, the changes proposed in ED/2010/13, and the requirements of IFRS 7 immediately after amendments resulting from ED/2010/13.

Comment letters

As there were 517 comment letters in the initial sample, NVivo, a software program designed to manage and analyse non-numerical, unstructured data (Bazeley & Jackson, 2013) was selected as it increases speed and improves coding reliability (Krippendorff, 2013). NVivo has been successfully used in similar research (e.g. Bamber & McMeeking, 2015).

A case-file was created in NVivo for each exposure draft and related comment letters were attached. Variables of interest called *attributes* in NVivo were added to each case-file. Each attribute had a range of possible *values* that were stakeholder responses in the comment letters. This approach facilitated the analysis, as results could be downloaded into Excel, and stakeholder responses to questions sorted and filtered in different combinations. Table 6.5 shows the NVivo coding attributes and values.

Identifying information was collected for each comment letter to establish the type of stakeholder and country of origin. Following established practice (e.g. Hodder & Hopkins, 2014), a classification hierarchy was used to resolve unclear or contradictory identifying information: (1) letterhead, (2) self-reference in the letter, and (3) signatory identifiable as an officer of a firm. In most instances, an internet search of the above clarified the classification. Individuals that responded but provided no affiliation were coded as 'other/individuals.' It is usual for researchers to add an additional category for respondents that may be individual accountants, consultants, or academics (e.g. Giner & Arce, 2012). This category does not form part of the analysis. Although country information was collected, it was not used, as it did not prove relevant to the analysis.

Table 6.4 NVivo coding attributes and values

Attributes	Values
Stakeholder category	Preparer – financial services Preparer – non-financial services Preparer industry body Audit firm Accounting industry body User Regulator Individual/other
Do you agree with the proposed disclosure?	Yes No
Reasons for disagreement	
Responses for ED7 (Q3)	Cost of disclosure [a] No comment/other
Responses for ED7 (Q6)	Risk disclosures should be in MD&A [b] No comment/other
Responses for ED/2008/10 (Q3(a))	Cost of disclosure Disagree with para 27B(c) No comment/other
Responses for ED/2009/3	Cost of disclosure Disagree with para 42D(d)-(g) No comment/other
Responses for ED/2010/13	Cost of disclosure Disagree with para 44-46 No comment/other

Note. This table shows NVivo coding attributes (variables of interest) and possible values (stakeholder responses) about each attribute. Coding attributes and values were created separately for each exposure draft. [a]Stakeholders described the proposed disclosures variously as too extensive, excessive, voluminous, prescriptive, onerous, or encouraging a checklist mentality. Stakeholders asked for quantitative uniform disclosures to be made narrative or discretionary. All such comments were concerned with the cost of providing the disclosures, as were direct mentions of cost. [b] MD&A = management discussion and analysis.

The questions in each exposure draft (see Table 6.3) first asked stakeholders whether they agreed with proposed changes to the disclosures. Therefore, the first step was to code for agreement or disagreement. For three of the four exposure drafts, agreement or disagreement meant agreeing or disagreeing with a large suite of new disclosures. The respondents stated position did not always coincide with their subsequent comments. Therefore, unclear or contradictory responses were coded based upon whether a stakeholder's qualification or disagreement was of a minor nature or seemed sufficient to indicate lack of support. This is an established approach (e.g. Bamber & McMeeking, 2015), although it is acknowledged that for complex issues, coding requires considerable time and judgement (Bamber & McMeeking, 2015). In this case, the researcher has significant experience with derivatives, including their disclosure. In this research, minor qualifications included requests for clarification or application guidance. Major qualifications that indicated disagreement included disagreement with a specific disclosure item, requests to make quantitative disclosures qualitative or optional, and comments that the proposed disclosures were overly prescriptive, excessive, onerous, burdensome, etc. Five examples of decisions that required judgement and reasons for the decisions are provided in Appendix G.

The second part of each question in the exposure drafts (see Table 6.3) asked respondents why they agreed or disagreed with the proposed disclosures. Following established practice (e.g. Bamber & McMeeking, 2015), reasons for disagreement were identified by reading through the first twenty comment letters for each exposure draft, identifying commonalities, and creating attributes and values in NVivo to record these common viewpoints. If a common viewpoint emerged later in the coding, a new attribute was added and all letters were re-coded. It is therefore likely that majority or significant minority viewpoints were identified.

One limitation of this coding approach was that the IASB might change an exposure draft based on a single comment letter. The IASB might also make changes unrelated to comment letters. The approach taken in this research does not identify the reasons for such changes, had they occurred. A second limitation was that while the manual coding approach had high validity, it risked low reliability. However, having one person code all of the responses mitigated this risk, as judgement was consistently applied (Bazeley & Jackson, 2013). Detailed coding notes were prepared for each exposure draft, documenting observations and reasoning (Miles & Huberman, 1994). This also served to increase coding reliability, as decisions were consistently applied.[24]

Some researchers have identified letter writing campaigns where large numbers of stakeholders have copied the response of a representative body onto their own letterhead (e.g. Hodder & Hopkins, 2014). No such campaigns were identified in this research.

6.3.5 Data analysis

Coded comment letters were downloaded from NVivo into Excel. This created a display matrix for each exposure draft that showed each attribute or variable of interest with a value (stakeholder response) entered for each comment letter. The analysis then proceeded in four stages. The first stage analysed lobbying behaviour and the response of the IASB to lobbying for each exposure draft. The second stage analysed lobbying behaviour by stakeholder category across the four exposure drafts. The third stage analysed types of arguments made by lobbyists and their effectiveness. The fourth stage identified stakeholder influence on IFRS 7 over the ten-year period of the analysis.

The first stage of the analysis was by exposure draft. Proposed new disclosure items in each exposure draft were assessed for their relation to one or more of the three analytical constructs. Agree/disagree responses from stakeholders to questions asked in each exposure draft identified lobbying activity. Stakeholder reasons for opposition to disclosures were summarised. Changes to proposed disclosures following public consultation were identified and associated, where appropriate, to lobbying activity.

[24] Inter-coder reliability is often tested in team research. For interpretive research with only one coder there is little benefit in having a second person code data as a test of reliability (Bazeley & Jackson, 2013; Krippendorff, 2013). Instead, what becomes important is "that the coder records the way he or she is thinking about the data, keeps track of decisions made, and builds a case supported by the data for the conclusions reached" (Bazeley & Jackson, 2013, p. 93).

The second stage of the analysis was by stakeholder category. For each stakeholder category, agree/disagree responses identified in the first analysis were summarised. Reasons given for disagreement with proposed disclosures in each exposure draft were identified and connected to the propositions and analytical constructs. This analysis answered sub-research question 3.1, which asked which disclosure characteristics different stakeholder groups preferred. Where necessary, comment letters were re-read and detailed notes and summaries were prepared to support the analyses.

For the third stage of the analysis, the reasons stakeholders gave for disagreement with proposed disclosures from the first and second analysis, were identified as either technical (to do with implementation), conceptual (to do with Conceptual Framework principles), or economic consequences (to do with cost) (e.g. Giner & Arce, 2012). The effectiveness of each type of argument was assessed for influencing the IASB.

For the fourth and final stage of the analysis, changes to the disclosure characteristics of IFRS 7 over the period (see coding in Appendices C to F) were summarised and compared to the propositions validated in the second stage of analysis. This answered research question 3, which asked whether the disclosure requirements of IFRS 7 were designed to meet the needs of users or preferred the needs of another stakeholder group. All documents used in the analysis were uploaded into NVivo and securely backed up on the QUT server.

6.4 Summary

This chapter explained the research design and methods for the two studies that comprise this research. Chapter 7 provides the results of the first study, which used interviews with bank analysts. Chapter 8 provides the results of the second study, a content analysis of IFRS 7 and related documents.

CHAPTER 7 STUDY ONE - RESULTS[25]

Chapter 6 described the research methods for the two studies that together answer the research questions and meet the objective of this research: to explore whether the derivatives disclosures required by IFRS 7 provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons. This chapter presents the results of the first study in which bank analysts were interviewed to obtain their views. Section 7.1 reviews the research questions and interview questions. Sections 7.2 presents the analysts' responses to the first interview question, Section 7.3 presents the analysts' responses to the second interview question, and Section 7.4 discusses the implications of the findings.

7.1 Research Questions

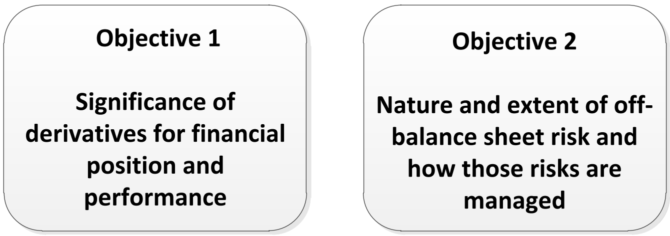
In the first study, 16 bank analysts were interviewed to answer two research questions. The first research question concerned what is presently required under IFRS 7. The second research question concerned what is not in IFRS 7 that might be useful to users. The research questions were:

RQ1 Do the disclosures for derivatives made under IFRS 7 fulfil their purpose by meeting the decision making needs of users, and if not, why not?

RQ2 To the extent that the disclosures for derivatives required by IFRS 7 are not useful, what disclosures would be more useful?

[25] Material presented in this chapter has been published in Bean and Irvine (2015).

The first interview question corresponded to the first research question and defined the decision-usefulness of the disclosures in accordance with IFRS 7. The interview question therefore paralleled the two high level objectives of IFRS 7 described in Section 4.1.



Analysts were asked, ‘To what extent do the disclosures in annual reports allow you to (1) evaluate the significance of derivatives to an entity’s financial position and performance, (2) understand the nature and extent of their risk, and (3) understand an entity’s practices and processes for managing that risk?’ The second interview question corresponded to the second research question and analysts were asked, ‘How do you think the disclosures required in IFRS 7 for derivatives could be improved, if at all?’

7.2 First Interview Question

In response to the first interview question, analysts saw the disclosures produced in accordance with IFRS 7 as a useful starting point, and all confirmed that they do read their clients’ annual reports. At a minimum, the accounts show open positions at year-end, which nine of the analysts believed provided some idea of the significance of derivatives to a company’s operations, consistent with the first objective of IFRS 7. These analysts considered the ability to identify the significance of derivatives for financial position and performance to be important, even subject to the limitations later identified. For example, it allows them to identify whether the derivatives a company holds at year-end seem appropriate for its business model. It enables them to look for red flags, that is, things that don't stack up. One senior analyst (SA14) observed that sometimes there was sufficient information for preliminary benchmarking of a client against its industry peers and competitors.

The majority of analysts identified two limitations affecting the usefulness of the disclosures in response to the first interview question. Both relate to the second objective of IFRS 7, which states that users should be able to understand an entity's risk and their practices and processes for managing that risk. These issues are discussed in the next three sub-sections. Sub-section 7.2.1 addresses the issue the analysts spent the most time discussing, the generic nature of the disclosures about risk and risk management usually provided by companies. The second limitation, analysts' identification of a potentially misleading end-of-year focus in many annual reports is discussed in sub-section 7.2.2. The analysts also talked about why they believed their clients did not provide disclosures that were more useful. This is discussed in sub-section 7.2.3.

7.2.1 The disclosures are generic

The majority of the analysts (14) were dissatisfied with the superficial or generic nature of disclosures.

> Part of the reason why I was interested in having this interview with you was because we actually do find it quite difficult to work out what the risks are for companies, just purely from public disclosures. (SA13)

> …the financial statements in general, are a very poor reflection of the risk management practices that are actually being used. (A10)

> I don’t think they’re particularly useful because of them being quite the same across different businesses. (A9)

Analysts emphasised that reading about companies’ policies and processes for identifying, measuring, and managing risks provides them with some idea of management’s understanding and sophistication in this area, which is important when dealing with derivatives. Further, analysts considered narrative disclosures essential to their ability to understand the quantitative information provided about risk exposures.

In terms of quantitative risk disclosures, six analysts noted that for sensitivity analyses of market risk most companies use a 1%, 5%, or 10% change in the risk variable irrespective of how realistic these changes might be. Of these, two said they still found this disclosure useful and four did not.

> I’ve seen 10% and I think I’ve seen 5% but they’re generally – look it’s an exercise for them, they need to tick a box. (A2)

These comments by analysts about generic disclosures are consistent with concern from practitioners identified in Section 4.1, that disclosures are growing in length while decreasing in informativeness (FRC, 2009, 2011; Hoogervorst, 2013; IASB, 2008a, 2008b; KPMG, 2011). The analysts’ comments also support the IASB’s disclosure recommendations in the discussion paper, A Review of the Conceptual Framework for Financial Reporting (IASB, 2013b). The discussion paper called for preparers to see financial statements as a form of communication guided by standards, as opposed to a “mechanism whose sole purpose is compliance with specific requirements of Standards” (IASB, 2013b para. 7.49).

7.2.2 Misleading end of period focus

The second limitation to the usefulness of the disclosures identified by nine of the 16 analysts was a perception that companies tend not to properly disclose their intra-period activity. The analysts believed that if or when activity during the year differed from year-end positions, companies in many cases either ignored these differences or else addressed them using generic narrative. Nine analysts said they had direct knowledge of companies doing this.

> For all you know, the day before, they've reduced their positions dramatically for their end of year reporting and then the following day, put them all back on again – and this absolutely happens. Companies manage their derivatives. (SA6)

> … if I looked at any type of public company, probably 80% of the time I'd presume they only use very vanilla derivatives, but the reality is … [the] non-vanilla stuff it's not there at year end, and that's common practice in companies; to use those other instruments in between period-ends. (SA11)

Some analysts linked this issue to the strict definitions of hedges in IAS 39 that may not match companies' economic reality, explaining that they had observed clients closing out positions before year-end to avoid disadvantageous accounting treatments.

> I think that behaviour is driven more by the restrictions in the current hedge accounting standards. Meaning that some businesses – no, not just some – many businesses that hedge look to the accounting standards to determine what sort of hedging they can use … Those tools might not get them the economic outcomes they want so they utilise different derivatives throughout the year to provide them with the exposure they really want. (A9)

> … a lot of our clients are happy to use purchase options … often this is considered the best form of risk management because you are protected [from losses greater than the premium paid] with only gain on the upside. But a lot of them will not have the options unexpired at year end. They clearly tell us we don't want this at year-end. So they would transact options during the year and a couple of days before year end … close out everything. (SA12)

The high-level aim of the new hedge accounting model in IFRS 9 is to better align companies' risk management practices with accounting outcomes, which may alleviate this problem. However, while it is possible that companies will find the new model more responsive to their needs, onerous hedging rules were not the sole reason given for the end of year focus of the accounts. Active decisions by audited companies to avoid disclosure were also mentioned by analysts.

> There's also strategy … [for example, using] the benefits of optionality to enhance a rate and then they close that out to ensure they don't carry any of these structured products over the year-end. (SA12)

> We do a bit of work with a very innovative treasury in the manufacturing sector and they're very aggressive. They do a lot of things like selling optionality … to boost their hedge rates and all that. They've got a policy around it, so they're not just [being] all very gung-ho about it. It's all within policy. But when you contrast that with what's disclosed in the financial statements, it's a far cry from that. So it's very innocuous in the financial statements, but in practice, and in reality, they're progressive, very aggressive. (A10)

If these perceptions accurately reflect practice, the non-disclosure of intra-period activity is concerning, whatever the reason. IFRS 7 specifically states that users must be able to evaluate "the nature and extent of risks arising from financial instruments to which the entity is exposed *during the period* and at the end of the reporting period" (IASB, 2005 para.1(b) emphasis added). Prior research has suggested that non-bank companies' use of derivatives for risk management is affected by the accounting treatment (Bodnar & Gebhardt, 1999; Glaum & Klöcker, 2011; Lins, Servaes, & Tamayo, 2011), and year-end window dressing for various reasons has been observed with banks (Allen & Saunders, 1992; Jones, 2011; Owens & Wu, 2014). However, existing research does not appear to identify that non-banks may be using derivatives, either for risk management or for speculation intra-period, without disclosing them.

When asked how they think companies avoid making these required disclosures, analysts blamed the use of generic descriptions in the narrative.

> They will just cover that by saying 'we sometimes transact FX options.' (SA11)

> That's what those one-liners around 'the company has used FX forwards and options to manage such and such risk, no such derivatives are outstanding at year end', that's where that comes from. But literally, those are one-liners in my experience. (SA13)

If these comments by analysts accurately portray practice, effectively avoiding disclosure by the use of broad-brush statements is not in the spirit of the accounting standard. By not making these activities clear, companies are essentially either overstating or understating their risk. For example, if companies are not disclosing that they are economically hedging a portion of their budgeted foreign currency revenue, they are implicitly overstating their exposure to foreign exchange risk. As one analyst pointed out, it would not be a particularly onerous requirement to ask companies to disclose information such as notional amounts bought and sold by type of instrument during the year, and would not require any change to the accounting standard. (SA11)

7.2.3 Reasons for uninformative disclosures

Many of the analysts offered opinions based upon their interactions with clients as to why they believed companies seem to have so much difficulty with the disclosures required by IFRS 7. Most commonly mentioned was companies' over-use of audit firms' example financial statements, which they variously linked to companies' belief that risk information is commercially sensitive; that companies may lack formal risk management policies, meaning they have nothing specific to disclose; and poor understanding of derivatives and risk by auditors and company accountants.

Over-use of audit firms example financial statements

Eight analysts suggested that audit firms allow companies to use boilerplate statements and mentioned companies copying the Big 4 example financial statements in this context.

> The accounting firms let companies get away with being so generic … I can tell you word for word what's in their disclosures … and it'll be something pulled out of the standard financial accounts. (SA11)

> It's almost like there's a cut and paste club amongst a lot of the financial reporting fraternity [laughs] that say, yes, these are the words that we can use to satisfy the requirements. (SA15)

That “financial reports provide evidence of auditors not being willing to exercise professional judgment” is an issue previously raised with the IASB (IASB, 2013a, p. 7). In turn, the IASB has suggested risk aversion may explain a compliance focused approach by auditors and preparers (Hoogervorst, 2013).

Information may be considered commercially sensitive

Nine analysts talked about the potential commercial sensitivity of risk information. Of these, eight believed that companies restrict information on risk management in the notes if or when they consider it commercially sensitive.

> …but I'm sure there's a degree of commercial practice in so far as you want to protect what your strategies might be. (A10)

> …most companies we deal with, they'll just keep to the standard and, I mean, they'll keep the full proper disclosure, but some of these matters might be commercially sensitive as well as, uncompetitive, so it's… (SA7)

However, there is an alternative view that at the high level such information could conceivably be included in an annual report, the information is not likely to be proprietary (Lee, 2012; Ryan, 2012). In several cases where the interviewer suggested this possibility, the analysts retreated from their sympathy with this viewpoint, agreeing that:

> I think there is, there's definitely a gap there that needs to be filled in, and I think it is possible to do that without giving away internal intellectual property. (SA5)

Companies lack formal risk management policies

Six analysts observed they did not believe many companies actually had detailed risk management policies and offered this as a possible reason for over reliance upon generic wording from audit firms' example financial statements.

> One thing that continues to surprise us is the number of companies whose boards actually don't have a formal treasury policy – and I'd say it's increasing. (SA14)

> We can't discount the situation where clients actually don't have any policies in place. You'd be very surprised … So the ambiguous disclosures you get in the financial statements may actually be accurate! (A10)

This is consistent with previous evidence that of Australia's top 100 companies, the top 50 are more likely to have properly documented policies and internal controls over derivatives than the bottom 50 (Matolcsy & Petty, 2001), potentially leaving any number of smaller listed companies without appropriate documentation of their strategies for risk management.

Accountants and auditors don't understand derivatives

Four analysts suggested that the use of generic templates, perhaps based upon standard financial statements, occurs because members of audit teams do not understand derivatives and risk any more than the corporate accountants who prepare the notes.

> I must admit I see … [our] amateur clients sitting with the auditor, and they seem to be very young, fresh-faced people who are not sure what sort of questions they're asking. [I don't know] whether they're just … ticking boxes. (SA15)

Concerning, but not necessarily surprising, is the possibility that accountants and auditors are out of their depth as derivatives increase in complexity. This has previously been raised in the literature (Le Guyader, 2013; Sikka, 2009).

7.3 Second Interview Question

The second interview question asked whether the analysts had any views on how they would like to see the disclosures improved beyond the current requirements of IFRS 7. In most cases, analysts referred back to matters already discussed, such as wanting better quality disclosures that are more company specific and informative. However, one new issue did stand out: analysts' inability to identify overall or economic risk from the current disclosures.

7.3.1 Disclosure of material economic risks and risk management

Seven of the analysts believed that IFRS 7 should require disclosures that provide a better view of companies' material risk and risk management activities. As outlined in Section 4.1, IFRS 7 requires disclosure of risk arising from financial instruments and separate disclosures on hedging arrangements that qualify for hedge accounting treatment. What IFRS 7 does not specifically require, however, is the disclosure of economic hedges or natural hedges. When a company enters into a transaction using derivatives for the purpose of risk management that does not qualify under the strict rules for hedge accounting, this is an economic hedge. Any such derivative would be classified as 'held for trading' under IAS 39 and it can be very difficult to identify its purpose as an economic hedge (Ernst & Young, 2008). A natural hedge arises when in the ordinary course of its business a company has positions that offset each other. A simple example might be foreign currency bank accounts naturally offsetting the currency risk of foreign currency accounts payable. Own contracts, forecasted transactions, and firm commitments, as well as net assets and profits and losses of foreign subsidiaries are also excluded, as they are outside of the scope of IAS 39 (Ernst & Young, 2008). There is consequently no requirement for a company to disclose the extent of its risk and risk management activities in any economic sense. Under current IFRS, risks, and especially hedging, are primarily accounting constructs.

Three of the analysts used foreign exchange risk as an example of a risk that they were interested in because it is often material for Australian companies.

> From our point of view we have to talk to the customer to get a full understanding of what FX exposures they've actually got – that company may have payables and receivables, [which] equals [a] natural hedge, but it certainly won't be 100% offset. There'll still be some FX exposure and I don't believe when I look at the notes I can tell what that is. Then they've got other currencies and cross currencies, and then AUD as functional currency … looking at this very small note that talks about some FX hedging or FX swaps that are currently entered into at the balance date; that doesn't give you a perspective of the year. It gives you no perspective of what the FX risk is on an on-going basis without going to the customer. Gives no idea what … they're doing to protect against volatility during the year. (SA14)

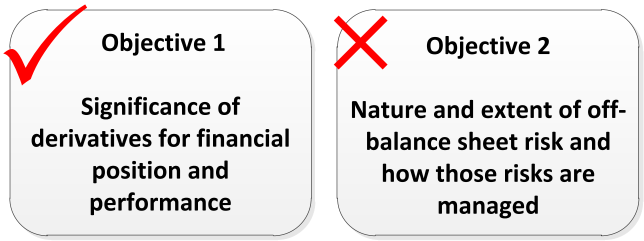
Others made the point that risk is not just about derivatives and financial instruments that are within the scope of IAS 39 and IFRS 7:

> A transport company for example, uses a lot of diesel, so they're exposed to diesel price risk, but what if, in their transport contracts with customers, they pass that diesel price risk through contractually. They've effectively hedged that risk and that might be – that might turn up in the notes to the accounts. It might not. (SA16)

What is particularly interesting about these comments, which were unprompted by the interviewer, is how closely they align with views expressed in research conducted by practice. For example, Ernst & Young (2008) noted that reconciling market risk disclosures with economic risk is difficult due to transactions falling outside the scope of IFRS 7. The CFA Institute in the UK (Papa & Peters, 2011, p. 2) recommended that companies "should provide an executive summary that distils key information on entity-wide risk exposures and effectiveness of risk management practices across different risk types." Standard setters must use judgement to strike a balance between sufficient levels of mandatory disclosure and imposition of costs. However, the adoption of IFRS 9, with its expanded hedging model and hedging disclosures based upon type of risk rather than type of hedge, perhaps provides an opportunity for companies to reflect on how they might link the disclosure of their hedging activities to their disclosure of financial risks.

7.4 Discussion and Implications

In response to the first research question, analysts identified poor disclosure quality limited the usefulness of information provided by companies in their annual reports. In particular, the analysts were dissatisfied with information provided about off balance sheet risk. In response to the second research question, the analysts again drew attention to companies' disclosure of off balance sheet risk and asked that IFRS 7 mandate a more integrated disclosure of economic risk. In both cases, the analysts identified issues connected to the second objective of IFRS 7, which requires companies to provide information about the nature and extent of risks arising from financial instruments.



The first interview question sought perceptions from sophisticated users of financial statements about the usefulness of the disclosures for derivatives. The analysts interviewed indicated that although the disclosures are useful to some extent, they tend to be prepared in a way that is generic and uninformative and focuses upon year-end positions to the detriment of any real understanding of risk and risk management practices. The analysts' responses to this question suggest that preparers may increase user satisfaction by making their existing disclosures less generic and more company specific. Given that concerns about the high cost of financial instruments disclosures have been identified in previous research (Johansen & Plenborg, 2013), this research may serve to alleviate those concerns. The interviews with analysts revealed little demand for non-banks to increase quantitative disclosure or undertake more advanced modelling that would be complex and therefore costly.

The perception that companies tend to disclose only end of year positions that may not be representative of transactions during the year was the second key issue identified in response to the first interview question. This problem was highlighted as one aspect in the collapse of Lehmann Bros and has been well-documented for samples of banks (Allen & Saunders, 1992; Owens & Wu, 2014). To the extent that companies do hold different positions during the year than at year-end, the inclusion of notional amounts by type of instrument traded may be a partial solution, and for most companies it would be relatively simple to provide this information.[26] It would also not require any change to IFRS 7.

In order to encourage companies to improve the informativeness of their disclosures, it is helpful to identify possible sources of resistance. Identifying an over reliance upon the example financial statements promulgated by audit firms, some analysts suggested that resistance to more informative disclosure might revolve around perceptions that information is commercially sensitive. The responses of the analysts when challenged on this viewpoint indicate potential benefits from educating preparers. Some analysts claimed that they observed their clients using derivatives without clearly documented strategies, limits, and internal controls. This would presumably have an effect upon a company's ability to explain its risk management strategy in the footnotes, and if widespread, could have important implications for company directors and auditors (e.g. Drummond, 2005). Some analysts believed a lack of understanding of derivatives and risk by both auditors and company accountants is a reason for companies to favour generic disclosures that are overly reliant upon audit firms' example financial statements. The audit of derivatives frequently focuses on review procedures (Gniewosz, Fargher, & Simnett, 2001), which are likely to be ineffective if not conducted by an auditor with the relevant knowledge of the area.

The response by the analysts in this study to the second interview question provides support to research conducted by practice (Ernst & Young, 2008; Papa & Peters, 2011, 2013) and indicates that usefulness could be improved if companies disclose their material risks in a more integrated way than is currently required under IFRS 7. While suggesting a need for

[26] An alternative sometimes suggested is for companies to report average positions during the period; however, not all companies currently revalue their positions regularly (Matolcsy & Petty, 2001) or update their hedge accounting, which might increase the cost of this approach.

further research in this area, these findings reinforce the conclusion of Johansen and Plenborg (2013) that companies should not underestimate user demand for this information.

This research also provides insights into how banks use the disclosures for derivatives. Most notable is the extent to which the analysts seem to focus upon qualitative disclosures. They use them to draw preliminary conclusions about the competence and sophistication of managements' risk strategies. Analysts made it clear that the numbers mean little without an information ecosystem to support them (Lee, 2012). This is different to studies that suggest analysts prefer quantitative, tabular disclosures (Campbell & Slack, 2008; Papa & Peters, 2011) and may reflect the dominant view of sell-side analysts in other research. Within financial risk, analysts focused on particular material risk categories, such as foreign currency, and identified the need for disclosures that provide insight into the overall risk in these areas. Analysts also used disclosures to identify red flags, that is, excessive or insufficient hedging, instruments that are inconsistent with other companies in the industry, or speculation.

7.5 Summary

This chapter presented the results of the first study that answered the first two research questions. Chapter 8 presents the results of the second study, an analysis of IFRS 7 and related documents, and answers the third research question and sub-research question.

CHAPTER 8 STUDY TWO - RESULTS

Chapter 7 presented the results of the first study based upon interviews with bank analysts. This chapter presents the results of the second study, a content analysis of documents relating to IFRS 7. Section 8.1 reviews the research questions. Section 8.2 provides a description of the characteristics of the stakeholders that responded to invitations to comment on the exposure drafts for IFRS 7. Section 8.3 presents the results of the first stage of analysis explained in Section 6.3.5, the analysis by exposure draft. Section 8.4 discusses the results of the second stage, the analysis by stakeholder category. Section 8.5 examines the results of the third stage, the analysis by type of argument and effectiveness. Section 8.6 presents the results of the fourth and final stage, the analysis of the characteristics of IFRS 7. Section 8.7 provides an overall discussion of the results and Section 8.8 considers their implications.

8.1 Research Questions

The objective of the second study was to identify whether IFRS 7 is designed to meet the needs of users, or by design, preferences the needs of another stakeholder group. The research comprised a content analysis of exposure drafts and comment letters written to the IASB by stakeholders over the ten-year period from 2004 to 2014. The research question was:

RQ3 Are the disclosure requirements of IFRS 7 designed to meet the needs of users, or do they preference the needs of another stakeholder group?

Relatively little is known about the specific disclosure preferences of some stakeholder categories. In order to answer research question 3, a sub-research question was added, SRQ3.1 What disclosure characteristics do different stakeholder groups prefer?

8.2 Stakeholder Characteristics

As shown in Table 6.3, the IASB received 517 comment letters in response to the exposure drafts included in the analysis. Of these, 459 respondents answered the six questions about disclosure also shown in Table 6.3.[27] Table 8.1 shows the 459 comment letters grouped by stakeholder category.

Table 8.1 Descriptive information for comment letters by stakeholder affiliation

Affiliation subgroup	Number	Overall percent (%)	ED7	ED/2008/10	ED/2009/3	ED/2010/13
Preparers						
Financial firms	87	19%	17	10	24	36
Non-financial firms	69	15%	5	10	5	49
Industry groups	100	22%	33	16	15	36
Sub-total	256	56%	55	36	44	121
Users						
Investors/advisors	11	2%	1	5	2	3
Accounting profession						
Audit firms	28	6%	5	6	7	10
Industry groups	75	17%	20	19	16	20
Sub-total	103	23%	25	25	23	31
Regulators	78	17%	15	20	20	23
Other/individuals	11	2%	1	1	0	9
TOTAL	459	100%	97	87	89	186

Note. This table reports information about the affiliations of 459 stakeholders that answered questions regarding disclosures affecting derivative financial instruments in ED7, ED/2008/10, ED/2009/3, and ED/2010/13.

27 No assumptions were made about the views of respondents that did not answer questions on proposed disclosure amendments and they were excluded from the analysis.

Users have tended not to contribute to the formal standard setting process for reasons of cost (Georgiou, 2010; Sutton, 1984), but also because they rely upon their professional bodies to represent them (Georgiou, 2010). Users submitted only 2% of letters in this study, and all were industry bodies representing either analysts or institutional investors.

Preparers were much more likely to write comment letters, submitting 56% of letters. This is consistent with prior literature (Chatham et al., 2010; Giner & Arce, 2012; Hodder & Hopkins, 2014; Jorissen et al., 2012, 2013). Preparers were the listed, often multi-national companies that prepare their financial statements in accordance with international accounting standards. Although financial companies (banks, insurance companies etc.) wrote more letters than non-financial companies, both categories were well represented at 19% and 15% respectively.

Letters from audit firms were from the Big 4 firms that responded to each exposure draft, and some mid-tier firms. There is little research evidence on audit firms' choice to participate in standard setting, although it would be reasonable to presume that they consider cost-benefit, as well as their expectation of influencing outcomes (Durocher & Fortin, 2011). It therefore follows that larger firms have the expertise required to participate in a complex subject such as financial instruments and it is also larger firms that are most affected by the requirements of international standards through their listed clients. Audit firms and accounting industry bodies represented 23% of letters written.

The majority of regulators that submitted letters were national standard setters, although this group also included stock exchanges, central banks, securities commissions, and supranational bodies such as the IOSCO and EFRAG. Regulators wrote 17% of all letters.

Those categorised as individuals and others provided no information about their affiliations. Representing 2% of letters, internet searches provided no conclusive results on name searches.

8.3 Results by Exposure Draft

This section presents the results of the first stage of analysis explained in Section 6.3.5, the analysis by exposure draft. Proposed new disclosure items in each exposure draft were assessed for their relation to one or more of the three analytical constructs.[28] Agree/disagree responses from stakeholders to questions asked in each exposure draft identified the direction of lobbying activity. Stakeholder opposition to specific disclosures and stated reasons were summarised. Changes to proposed disclosures following public consultation were identified and compared to lobbying activity.

8.3.1 ED 7 Financial instruments: Disclosures

From 1998, IAS 32 had been the disclosure standard for financial instruments, supplemented by industry standard IAS 30 for banks and regulated financial institutions. Recognising the increasing exposure of non-banks to the kind of risks traditionally associated with the financial services sector (IASB, 2004), in 2004 the IASB exposed ED 7 Financial Instruments: Disclosures. ED 7 was a proposed new standard that would replace both IAS 32 and IAS 30. ED 7 increased the disclosure of risk and risk management for all companies, and reduced flexibility and disclosure choice. One substantial new disclosure proposed in ED 7 was a sensitivity analysis of market risk. The proposed sensitivity analysis of market risk was a complex disclosure that required estimation and judgement.

[28] The analytical constructs are uniform, complex and commercially sensitive disclosures (Section 6.3.2).

Of the 99 responses to the exposure draft, 97 respondents answered two questions concerning the disclosure of market risk. The IASB asked questions about the sensitivity analysis and about its location within the annual report. Question 3 in the exposure draft asked whether stakeholders agreed that the proposed sensitivity analysis of market risk was practicable for all entities. Question 6 asked whether risk disclosures, including the proposed sensitivity analysis, should be part of the audited financial statements. Table 8.2 combines the responses from question 3 and question 6 to show the number of stakeholders that agreed/disagreed there should be a sensitivity analysis of market risk *and* that it should be in the audited notes of the financial statements.

Table 8.2 Comment letter responses for ED 7

Stakeholder category	Number	Overall percent (%)	Agree	%	Disagree	%
Preparers						
Financial firms	17	18%	2	12%	15	88%
Non-financial firms	5	5%	1	20%	4	80%
Industry groups	33	34%	6	18%	27	82%
Sub-total	55	57%	9	16%	46	84%
Users						
Investors/advisors	1	1%	1	100%		0%
Accounting profession						
Audit firms	5	5%	1	20%	4	80%
Industry groups	20	21%	3	15%	17	85%
Sub-total	25	26%	4	16%	21	84%
Regulators	15	15%	8	53%	7	47%
Individuals/other	1	1%		0%	1	100%
TOTAL	97	100%	22	23%	75	77%

Note. This table reports information by stakeholder affiliation for 97 comment letters submitted to the IASB that responded to questions 3 and 6 in exposure draft ED7. Results are for combined responses to question 3 and 6 in ED 7. Question 3 asked whether respondents agreed that the proposed sensitivity analysis of market risk was practicable for all entities. Question 6 asked whether risk disclosures, should be part of the audited financial statements. Question 3 x 6 therefore identifies how many respondents agreed/disagreed that there should be a sensitivity analysis of market risk *and* that risk information should be included in the audited financial statements.

Table 8.2 shows that a majority of preparers (84%) opposed the inclusion of a sensitivity analysis in the financial statements. Audit firms aligned with their clients in opposing a disclosure that was complex, requiring estimation and judgment (80%). Accounting industry groups shared this view (85%). One user responded to the invitation to comment and supported the new disclosure. Regulators supported the new disclosure (53%) taking a user perspective in favour of increased transparency.

Analysis of the reasons why stakeholders opposed the disclosures showed that of the 75 (77%) respondents across all categories that opposed the proposals 52 (53%) said that the sensitivity analysis would be impractical, if not irrelevant, for entities that do not use this method as part of their internal management process, and/or requested a less prescriptive approach. These objections referenced the cost of the disclosure.[29] Fifty-nine (79%), believed that risk disclosures should not be audited.

> While we understand the users' needs for a sensitivity analysis, we consider that the Board should recognise that such analysis is cumbersome to prepare for industrial and commercial enterprises that generally do not have the same sophisticated systems and staff nor the same analysis methods and formats as financial institutions. Therefore, such disclosures should be limited to a summary of the sensitivity analysis prepared internally for management. If an enterprise does not prepare a sensitivity analysis, it should disclose this fact. (CL40 Nestlé S.A., Vevey Switzerland)

IASB response following ED7

Appendix C compares the disclosure requirements of IAS 32 with the proposals contained in ED 7, and IFRS 7 when it was issued in 2005. For the sensitivity analysis of market risk, one

[29] In comment letters, stakeholders variously described proposed disclosures as too extensive, excessive, voluminous, prescriptive, onerous, or encouraging a checklist mentality. They asked for quantitative uniform disclosures to be made narrative or discretionary. The usefulness of disclosures to users was questioned (a cost/benefit argument). All such comments are concerned with the cost of providing the disclosures, as are direct mentions of cost.

substantive change made by the IASB following public comment was to replace a requirement to quantify the effect when the analysis is unrepresentative of the risk inherent in financial instruments (a complex disclosure item) with a requirement to explain (a narrative disclosure item). This is connected to one of the limitations of the disclosures identified by bank analysts in the first study: that year-end balances are not necessarily representative of intra-period transactions and companies may not clearly disclose this. The change does not appear to be associated with the comment letters. The IASB did not respond to significant opposition to the proposed sensitivity analysis from preparers (84%) and the accounting profession (84%). Arguments that market risk disclosure requirements were not practicable or that risk information was more suited to the unaudited management commentary were not effective.

8.3.2 ED/2008/10 Improving disclosures about financial instruments

In October 2008, the IASB issued exposure draft ED/2008/10 Improving Disclosures about Financial Instruments. Its primary objective was to improve IFRS 7 to enhance disclosures about valuations, methodologies, and the uncertainty associated with fair value measurements identified during the 2007/8 financial crisis (IASB, 2008c). Proposed changes centred upon the introduction of a three-level fair value disclosure hierarchy that distinguished between the observability of inputs used in calculating fair value.

Of the disclosures proposed in ED/2008/10, some were existing disclosures made consistent with the new disclosure hierarchy. New disclosures in ED/2008/10 applicable to derivatives were in section 27B and included a requirement for a reconciliation of items measured using Level 3 inputs, a requirement to disclose movements between levels in the fair value hierarchy, and a requirement to disclose realised and unrealised gains and losses separately. The first two disclosures were uniform disclosures; however, the third requirement to disclose realised and unrealised gains and losses was less clear, as it introduced questions about what realised and unrealised actually mean. For example, companies may not be able to identify realised and unrealised amounts for a derivative that has periodic exchanges of cash prior to settlement. This proposed disclosure was therefore complex.

Unrelated to the fair value project, in ED/2008/10 the IASB also proposed a change to the disclosure of liquidity risk. Where a contractual maturity analysis had been required, the IASB proposed that for derivatives, the maturity analysis be prepared based upon management expectations. Changing one uniform disclosure to a different uniform disclosure prepared from information used internally by management would reduce incremental processing costs for preparers, without changing the nature or extent of the disclosure for audit purposes. If the disclosure better reflected the management of liquidity risk and management expectations about future cash flows, then it would also increase transparency for users.

Of the 88 responses to the exposure draft, 87 answered the questions about disclosure. Table 8.3 provides information about the comment letter responses for ED/2008/10. Panel A reports the results from question 3(a) which asked stakeholders whether they agreed with disclosures in section 27B of the exposure draft, for items measured at fair value using Level 3 inputs. Overall, preparers opposed the disclosures (64%) however, only 30% of non-financial firms opposed them, perhaps because non-financial firms have fewer Level 3 valuations (Gebhardt, 2012) and would not bear the cost. Of six audit firms that responded, three (50%) opposed and three (50%) supported all of the proposed disclosures. Accounting industry groups (74%), users (100%), and regulators (90%) supported the disclosures.

Table 8.3 Comment letter responses for ED/2008/10

Stakeholder category	Number	Overall percent (%)	Agree	%	Disagree	%
Panel A: Comment letter responses for Q3(a)						
Preparers						
Financial firms	10	11%	3	30%	7	70%
Non-financial firms	10	11%	7	70%	3	30%
Industry groups	16	20%	3	19%	13	81%
Sub-total	36	42%	13	36%	23	64%
Users						
Investors/advisors	5	6%	5	100%		0%
Accounting profession						
Audit firms	6	7%	3	50%	3	50%
Industry groups	19	21%	14	74%	5	26%
Sub-total	25	28%	17	68%	8	32%
Regulators	20	23%	18	90%	2	10%
Individuals/other	1	1%	1	100%		0%
TOTAL	87	100%	54	63%	33	38%
Panel B: Comment letter responses for Q4						
Preparers						
Financial firms	10	11%	10	100%		0%
Non-financial firms	10	11%	7	70%	3	30%
Industry groups	16	20%	15	94%	1	6%
Sub-total	36	42%	32	89%	4	11%
Users						
Investors/advisors	5	6%	4	80%	1	20%
Accounting profession						
Audit firms	6	7%	6	100%		0%
Industry groups	19	21%	17	89%	2	11%
Sub-total	25	28%	23	92%	2	8%
Regulators	20	23%	15	75%	5	25%
Individuals/other	1	1%	1	100%		0%
TOTAL	87	100%	75	86%	12	14%

Note. This table reports information by stakeholder affiliation for 87 comment letters received by the IASB for questions 3(a) and 4 in ED/ 2008/10. Panel A reports information for question 3(a) that asked if respondents agreed with disclosures contained in section 27B of the exposure draft. Panel B reports information for question 4 that asked if respondents agreed with a proposal to disclose a maturity analysis of derivative financial instruments.

Analysis of the reasons why stakeholders opposed the disclosures showed that of the 33 (38%) respondents across all categories that opposed the proposals, 25 (76%) requested they be reduced or made less prescriptive and 16 (48%) disagreed with paragraph 27B(c) that required the separate disclosure of unrealised gains and losses.

> There is currently no definition in IFRSs of “realised” versus “unrealised” gains or losses and therefore it may be unclear which items would be included in the total amount of unrealised gains or losses for the period… Furthermore, we believe that for financial instruments with periodic cash settlements (e.g., interest rate swaps), these interpretive issues may be particularly pronounced and preparers may encounter practical difficulties and cost... (CL44 KPMG IFRG Limited, London UK)

Panel B of Table 8.3 reports the results from question 4, which asked if respondents agreed with the proposal to disclose a maturity analysis of derivative financial instruments based on how companies manage liquidity risk. Preparers supported a disclosure that had lower incremental processing costs (89%).[30] There was no economic effect for auditors from the proposed change and they supported their clients (100%) as did accounting industry groups (89%). Users (80%) and regulators (75%) supported the disclosure. Of five (25%) regulators that disagreed with the change, all identified a potential reduction in informativeness, particularly in an illiquid market such as occurred during the 2007/8 financial crisis. These regulators wanted information on contractual maturities retained.

> We support the proposal to disclose expected maturities of derivative financial liabilities on the basis that it will provide insights to users about how management manages liquidity risk. [However] … where markets are fluctuating and unstable, management’s expected values may be unrealistic

[30] This shows preparers differentiate between disclosures that increase transparency and disclosures that increase processing costs, and that it is increased processing costs to which they object.

> and, therefore, in the interests of transparency, information about maximum exposure may be of particular relevance. (CL3 Accounting Standards Board, London UK)

IASB response following ED/2008/10

Appendix D provides a comparison of IFRS 7 before and after exposure draft ED/2008/10. There were two substantive changes following public consultation on ED/2008/10, both of which seemed associated with lobbying. First, the IASB modified the requirement of paragraph 27B(c) so that companies did not have to separate unrealised gains and losses from total gains and losses for fair value measurements categorised within Level 3 of the fair value hierarchy.[31] Second, in respect to question 4 on liquidity risk, the IASB added a requirement for companies to include information on contractual maturities of derivative financial liabilities where it is necessary to understand the timing of the cash flows. For question 3(a) the IASB did not respond to requests that the fair value disclosures in section 27B be reduced or made less prescriptive.

8.3.3 ED/2009/3 Derecognition

In April 2009, the IASB issued exposure draft ED/2009/3 Derecognition, which proposed amendments to both IAS 39 and IFRS 7. The exposure draft was a response to problems identified during the 2007/8 financial crisis particularly with regard to asset securitisations (IASB, 2009a). In ED/2009/3, the IASB invited comment on a number of new disclosures for assets that are derecognised but for which a company has continuing involvement. Contained in sections 42D and 42E of the exposure draft, these were mainly uniform disclosures. Two subsections were notable, in that they required companies to present information on derecognised assets as if they had not been derecognised. Companies would be required to

[31] The IASB later reinstated this requirement in IFRS 13 (para.93 (f)).

disclose fair values and the methods and assumptions used in arriving at fair value (section 42D(d)), and also provide a sensitivity analysis of the risk variables used in estimating fair value (section 42D(g)). Obtaining this information for assets no longer controlled would be potentially costly. Both of these proposed disclosures were complex, requiring estimation.

Of the 114 responses to the exposure draft, 89 answered the question on disclosures. Table 8.4 provides information on the comment letter responses for question 11 of ED/2009/3, which asked whether stakeholders agreed with the proposed disclosures for derecognised assets.

Table 8.4 Comment letter responses for ED/2009/3

Stakeholder category	Number	Overall percent (%)	Agree	%	Disagree	%
Preparers						
Financial firms	24	27%	1	4%	23	96%
Non-financial firms	5	5%	1	20%	4	80%
Industry groups	15	17%	1	7%	14	93%
Sub-total	44	49%	3	4%	41	93%
Users						
Investors/advisors	2	2%	2	100%		0%
Accounting profession						
Audit firms	7	8%	3	43%	4	57%
Industry groups	16	18%	6	37%	10	63%
Sub-total	23	26%	9	39%	14	61%
Regulators	20	23%	7	35%	13	65%
TOTAL	89	100%	21	24%	68	76%

Note. This table reports information by stakeholder affiliation for 89 comment letters in response to question 11 of exposure draft: ED/2009/3. Question 11 asked respondents if they agreed with proposed amendments with respect to derecognised financial assets.

Preparers objected to the proposed disclosures (93%). Of seven audit firms that responded, three (43%) agreed with the disclosures and four (57%) disagreed. Two users that responded supported the disclosures (100%). Unlike previous exposure drafts, regulators did not align with users in favour of increased transparency. Sixty-five percent of regulators opposed the disclosures, which was a preparer perspective.

Analysis of the reasons why stakeholders opposed the disclosures showed of the 68 (76%) stakeholders across all categories that opposed the proposals, 62 (91%) said the disclosures were too extensive. Thirty respondents (44%) criticised one or both of subsections 42D (d) and (g).

> Although we think the disclosures should focus on the nature and extent of the risks associated with the entity's continuing involvement in assets and on the main judgement calls made in preparing the financial statements, our assessment is that the proposed disclosures go beyond that. … In our view the proposed disclosures give the impression that they are trying to make up for a derecognition model that is flawed. … We do not understand why the disclosures about transferred financial assets that have been derecognised are so much more extensive than those required for transferred assets that are not derecognised … [We] are concerned that what then follows seems like a long list of disclosures, only some of which are likely to provide useful information in any particular circumstance. In our view lists of this kind encourage a checklist mentality in exactly the circumstances in which thoughtful implementation is needed. (CL47 European Financial Advisory Group, Brussels Belgium)

IASB response following ED/2009/3

Appendix E provides a comparison of IFRS 7 before and after exposure draft ED/2009/3. Following public consultation there were two substantive changes that seemed associated with lobbying. These were the removal of the proposed requirement for companies to provide the fair value of derecognised financial assets in which they have a continuing involvement (section 42D (d)), and removal of the sensitivity analysis showing the possible effects of changes in the risk variables on those fair values (section 42D (g)). The IASB did not respond to objections that the proposed disclosures were too extensive.

8.3.4 ED/2010/13 Hedge accounting

ED/2010/13 Hedge Accounting proposed fundamental changes to the hedge accounting model in IAS 39 and made significant consequential changes to IFRS 7. The aim of the new hedge accounting model was to better align companies risk management practices with accounting outcomes (IASB, 2014a). To this end, the proposed model significantly expanded the scope of risk management activities that would qualify for hedge accounting. The proposed disclosures that followed from this were fundamentally different to existing requirements in that their starting point was the type of risk exposure rather than the type of hedge. The IASB also substantially increased the volume of disclosures (Figure 2.3).

While most of the proposed new disclosures were uniform in nature, two disclosures were of note. First, IFRS 7 had always required companies to explain their risk management strategy. ED/2010/13 added a specific requirement for companies to explain their risk management strategy where hedge accounting was adopted (paragraph 44). Although strategic information can be commercially sensitive, narrative disclosures are not usually commercially sensitive because managers have discretion over what they say. However, ED/2010/13 added a further requirement in paragraph 45 for companies to quantify their risk exposures, the extent to which those exposures are hedged, and the effect on hedging strategy for each risk exposure. Taken together with paragraph 44, paragraph 45 proposed the disclosure of information that could be commercially sensitive for some companies. This disclosure was commercially sensitive, but was uniform rather than complex, as estimation and judgement were not required. Second, paragraph 46 required companies to provide quantitative forward estimates of cash flows over the term of their hedges, which in some cases could span many years and could include estimating and disclosing plans for future sales, purchases, etc. Potentially requiring the disclosure of commercially sensitive information to competitors, paragraph 46 was also complex, requiring estimation and judgement.

Of the 213 responses to the exposure draft, 186 answered two questions concerning disclosure. Table 8.5 provides information on the comment letter responses for ED/2010/13. Panel A reports the results from question 13(a), which asked whether respondents agreed with the proposed amendments to IFRS 7 for hedge accounting. Preparers opposed the new disclosures (75%). Of the 10 audit firms that responded, three (30%) agreed with all of the disclosures and seven (70%) disagreed. The accounting industry bodies were evenly divided (50%). Three users that responded supported the disclosures (100%); however, regulators aligned with preparers and a majority (57%) opposed the disclosures.

Analysis of the reasons why stakeholders opposed the disclosures showed that of 123 (66%) respondents across all categories that opposed the disclosures, 92 (74%) said that the disclosures were too extensive. Sixty-nine (56%) singled out paragraphs 45 and/or 46 for requiring the disclosure of potentially commercially sensitive information.

> Most notably, we reject the proposals outlined [in paragraph 46]. As those disclosures should be made for 'each subsequent period' and are therefore of a strong prognostic character, we entirely reject the current proposal to present such extremely sensitive information … (CL39 Daimler AG, Stuttgart Germany)

Table 8.5 Comment letter responses for ED/2010/13

Stakeholder category	Number	Overall percent (%)	Agree	%	Disagree	%
Panel A: Comment letter responses for Q13(a)						
Preparers						
Financial firms	36	19%	11	31%	25	69%
Non-financial firms	49	27%	11	22%	38	78%
Industry groups	36	19%	8	22%	28	78%
Sub-total	121	65%	30	25%	91	75%
Users						
Investors/advisors	3	2%	3	100%		0%
Accounting profession						
Audit firms	10	6%	3	30%	7	70%
Industry groups	20	11%	10	50%	10	50%
Sub-total	30	16%	13	43%	17	57%
Regulators	23	12%	10	43%	13	57%
Other/individuals	9	4%	7	78%	2	22%
TOTAL	186	100%	63	34%	123	66%

Stakeholder category	Number	Agree	%	Uniform	Commercially sensitive
Panel B: Comment letter responses for Q13(b)					
Preparers					
Financial firms	36	1	3%	1	1
Non-financial firms	49	4	8%	3	1
Industry groups	36		0%		
Sub-total	121	6	5%	4	2
Users					
Investors/advisors	3	2	67%		2
Accounting profession					
Audit firms	10	5	50%	3	3
Industry groups	20	4	20%	1	3
Sub-total	30	10	33%	4	6
Regulators	23	5	22%	3	3
Other/individuals	9	2	22%	1	1
TOTAL	186	25	19%	12	14

Note. This table reports information by stakeholder affiliation for 186 comment letters for exposure draft ED/2010/13. Panel A reports the results to question 13(a) that asked whether stakeholders agreed with the proposed disclosure requirements for hedge transactions. Panel B reports results to question 13(b) that asked what additional disclosures respondents suggested would be useful. Additional disclosures are identified by analytical construct. For Panel B, numbers do not add across as some respondents requested more than one type of additional disclosure.

Question 13(b) asked respondents to suggest additional disclosures. Panel B of Table 8.5 reports the type of disclosure requested by stakeholders in accordance with the analytical constructs. Requests for companies to provide more information when they rebalance a hedge, explain how they perform their hedge effectiveness testing, and to provide more information on partial hedges were all examples of requests from stakeholders for uniform disclosures. There were no requests for complex disclosures that require estimation and judgement. Stakeholder requests for commercially sensitive disclosures in Table 8.5 were for companies to disclose their overall risk management strategies and economic hedging arrangements in addition to the requirements of paragraphs 44 and 45. As expected, very few preparers wanted more disclosure (5%) and few regulators (22%). However, 50% of audit firms wanted more uniform disclosures and/or more risk management disclosures that companies may consider commercially sensitive, as did two of three (67%) users.

> … in paragraph 44 an entity should not only describe its risk management strategy for those risks it hedges but should do so for all risks - an entity that hedges should not have to provide more detailed disclosures. In this context, in the interests of producing a more cohesive framework, the IASB should consider disclosures in relation to financial instruments as a whole. (CL100 Investment Management Association, London UK)

IASB response following ED/2010/13

Appendix F provides a comparison of IFRS 7 before and after ED/2010/13. Changes to IFRS 7 will become effective for companies when they adopt IFRS 9 from 2018 or earlier. The IASB did not respond to claims from stakeholders that the proposed disclosures were too extensive and added more than 10 new uniform disclosure items following public consultation, including the disclosures requested by stakeholders in response to question

13(b). The IASB did not extend the risk management disclosures of paragraph 44 and 45 to include economic hedging activities as also requested by some stakeholders, and instead removed proposed paragraphs 45 and 46. The IASB replaced these paragraphs with a requirement to provide summary information on the notional amounts and timing of hedging instruments (a uniform disclosure).

8.4 Results by Stakeholder Category

This section presents the results of the second stage of the analysis explained in Section 6.3.5, the analysis by stakeholder category. For each stakeholder category, agree/disagree responses identified in the first analysis were summarised. Reasons given for disagreement with proposed disclosures in each exposure draft were analysed and connected to propositions and analytical constructs.

8.4.1 Users

In Section 4.5, the proposition was developed that users would support all uniform, complex, and commercially sensitive disclosures that increase transparency (P_1). All of the exposure drafts tested this proposition. Table 8.6 summarises the results for $P_{1,}$ which was supported.

Table 8.6 User responses to comment letters on P_1

Users	Number	Agree	%	Disagree	%
ED7	1	1	100%		0%
ED/2008/10 (Q3(a))	5	5	100%		0%
ED/2008/10 (Q4)	5	4	80%	1	20%
ED/2009/3	2	2	100%		0%
ED/2010/13	3	3	100%		0%
TOTAL	11	10	91%	1	9%

Note. This table reports information about 11 letters from users on on P_1 that users would support all disclosures that increase transparency, in ED7, ED/2008/10, ED/2009/3, and ED/2010/13.

For each exposure draft, users showed support for all increases in disclosure except for question 4 of ED/2008/10. In this case, one user opposed a proposed maturity analysis for liquidity risk, as they preferred a more sophisticated duration analysis. From analysis of the comment letters, there were no instances of a user suggesting fewer disclosures, or that a particular disclosure might not be necessary. Users did not mention the cost or difficulty for preparers of providing information. Of 11 letters submitted by users to the IASB for the four exposure drafts, seven (64%) requested more disclosure than was in the exposure draft.

8.4.2 Preparers

In Section 4.5, the proposition was developed that preparers would oppose increases in both uniform and complex disclosures that increased their processing costs (P_2). All of the exposure drafts tested this proposition. Table 8.7 Panel A, shows P_2 was supported with a majority of preparers opposing all increases in disclosure (79%).

Table 8.7 Preparer responses to comment letters on P_2 and the analytical construct complex disclosure

Preparer	Number	Agree	%	Disagree	%
Panel A: Preparers response on P_2					
ED7	55	9	16%	46	84%
ED/2008/10	36	13	36%	23	64%
ED/2009/3	44	3	7%	41	93%
ED/2010/13	121	30	25%	91	75%
TOTAL	256	55	21%	201	79%

	Disagree	Oppose complex	%
Panel B: Opposition to complex disclosure			
ED/2008/10	23	12	52%
ED/2009/3	41	16	39%
ED/2010/13	91	52	57%
TOTAL	155	80	52%

Note. Panel A reports information about 256 letters from preparers and their industry bodies in ED7, ED/2008/10 (Q3 (a)), ED/2009/3 and ED/2010/13 (Q13 (a)). Panel A shows preparers that opposed increased disclosures (P_2). Panel B compares the extent of opposition to increases in disclosure, to the extent of opposition to specific complex disclosures for ED/2008/10 (Q3 (a)), ED/2009/3 and ED/2010/13 (Q13 (a)).

For three exposure drafts, stakeholders were asked to comment on the introduction of multiple disclosures with varying characteristics (uniform, complex and/or commercially sensitive). For these, preparers often identified specific disclosures that were of concern. These were always complex or commercially sensitive disclosures.[32] Table 8.7 Panel B compares the extent of opposition to increases in disclosure, to the extent of opposition to specific complex disclosures. Panel B shows that preparers objected to increased disclosures more frequently than they objected to specific complex disclosures.

Preparers were also expected to oppose commercially sensitive disclosures (P_3). One exposure draft tested this proposition: ED/2010/13 required quantification of risk exposures and future cash flows associated with hedging. Table 8.8 summarises the results for P_3, which was supported.

Table 8.8 Preparer responses to comment letters on P_3

Preparers	Number	Agree	%	Disagree	%	Oppose commercially sensitive	%
ED/2010/13							
Financial firms	36	11	31%	25	69%	6	24%
Non-financial firms	49	11	22%	38	78%	29	76%
Industry groups	36	8	22%	28	78%	17	61%
TOTAL	121	30	25%	91	75%	52	57%

Note. This table reports information for 121 letters in response to ED/2010/13 on P_3 that preparers would oppose commercially sensitive disclosures.

Table 8.8 shows that of those that opposed the new disclosures, 52 of 91 (57%) disagreed with disclosures they identified as commercially sensitive. However, for non-financial companies, the number was higher, with 29 of 38 (76%) objecting to the disclosure of commercially sensitive information. This may reflect the competition that non-financial

[32] As explained in Section 6.3.4, coding captured majority and significant minority viewpoints.

companies face from private companies compared to banks and insurance companies. Non-financial companies may also be more likely to hedge future transactions they believe are commercially sensitive.

8.4.3 Audit firms

In Section 4.5 the proposition was developed that audit firms would support increases in uniform disclosure that would increase audit fees without any increase in audit risk (P_4). Three of the four exposure drafts tested this proposition. Table 8.9 shows that P_4 was supported with audit firms strongly supporting new uniform disclosures for all three exposure drafts at 67%, 71% and 70%.

Table 8.9 Audit firm responses to comment letters on P_4

Audit firms	Number	Agree	%	Disagree	%	Support uniform disclosure	%
ED/2008/10	6	3	50%	3	50%	4	67%
ED/2009/3	7	3	43%	4	57%	5	71%
ED/2010/13	10	3	30%	7	70%	7	70%
TOTAL	23	9	39%	14	61%	16	70%

Note. This table reports information about 23 letters from audit firms on on P_4 that audit firms will support uniform disclosure, in ED/2008/10, ED/2009/3, and ED/2010/13.

It was also proposed in Section 4.5 that auditors would align with their clients and oppose complex disclosures (including complex commercially sensitive disclosures) that required estimation and judgment (P_5). All exposure drafts tested this proposition. Table 8.10 analyses the results for P_5 and shows that when audit firms opposed a proposed disclosure, they were likely to refer to the high cost to preparers (61%) but directed attention to specific complex disclosures (72%), more frequently than to specific uniform disclosures (22%). P_5 was therefore supported.

Table 8.10 Audit firm responses to comment letters on P_5

Audit firms	Number	Disagree	%	Oppose processing cost	%	Oppose uniform	%	Oppose complex	%
ED7	5	4	80%	3	75%			4	100%
ED/2008/10	6	3	50%	3	100%	2	67%	2	67%
ED/2009/3	7	4	57%	2	50%	2	50%	3	75%
ED/2010/13	10	7	70%	3	43%			4	57%
TOTAL	28	18	64%	11	61%	4	22%	13	72%

Note. This table reports information about 28 letters from audit firms in ED7, ED/2008/10, ED/2009/3, and ED/2010/13 on P_5 that audit firms would oppose complex disclosure. Numbers do not add across as audit firms provided more than one reason for disagreement.

8.4.4 Regulators

In Section 4.5 the proposition was developed that regulators would support the interests of preparers (P_6). This proposition was tested by all of the exposure drafts. Table 8.11 provides information showing the responses of regulators for each exposure draft which indicates P_6 is not supported.

Table 8.11 Regulator responses to comment letters on P_6

Regulators	Number	Agree	%
Panel A: Support proposed disclosures			
ED7	15	8	53%
ED/2008/10	20	18	90%
ED/2009/3	20	7	35%
ED/2010/13	23	10	43%
TOTAL	78	43	55%

	Number	Disagree	%	Oppose processing cost	%	Oppose commercially sensitive	%
Panel B: Oppose proposed disclosures							
ED7	15	7	47%	4	57%		
ED/2008/10	20	2	10%	2	100%		
ED/2009/3	20	13	65%	12	92%		
ED/2010/13	23	13	57%	11	85%	5	38%
TOTAL	78	35	45%	29	83%	5	6%

Note. This table reports information for 78 letters submitted by regulators for ED7, ED/2008/10, ED/2009/3, and ED/2010/13. Panel A shows support for all proposed disclosures (a user perspective). Panel B shows opposition to disclosures that have high processing costs or are commercially sensitive (a preparer perspective). Panel B totals do not add across as regulators may give more than one reason or no reason for their disagreement, or give a different reason for disagreement.

As shown in Table 8.11 Panel A, for ED 7 and ED/2008/10 regulators took a user perspective, with 53% supporting the disclosures in ED 7 and 90% supporting those in ED/2008/10. However as shown in Panel B, for ED/2009/3, 13 of 20 regulators (65%) opposed disclosures for derecognised assets and of these, 12 (92%) referenced the high cost of the proposals. For ED/2010/13, 13 of 23 regulators (57%) opposed the disclosures of which 11 (85%) referenced the high cost while 5 (38%) identified that some of the proposals could result in the disclosure of commercially sensitive information. Mixed results may reflect that as the disclosure requirements of IFRS 7 have grown longer and more detailed, regulators have increasingly taken a preparer perspective.

8.5 Effectiveness of Stakeholder Arguments

This section presents the results of the third stage of the analysis explained in Section 6.3.5, an analysis of the effectiveness of different types of argument made by stakeholders. The reasons stakeholders gave for disagreement with proposed disclosures were identified as either technical (to do with implementation), conceptual (to do with Conceptual Framework principles) or economic consequences (to do with cost).

For ED7, most of the complaints about the sensitivity analysis referenced cost and had no effect on the position of the IASB. For ED/2008/10, objections to calculating realised and unrealised gains for some derivatives were mainly technical and the request by some regulators to reinstate information on contractual maturities of derivative financial liabilities was conceptual. Both of these resulted in amendments. For ED/2009/3, two disclosures that would allow users to unwind the effect of derecognised transactions were challenged and removed, probably on conceptual grounds. As some stakeholders pointed out, it seems unlikely that the objective of disclosure is to facilitate the unwinding of transactions accounted for in accordance with recognition and measurement standards. For ED/2010/13, the source of objection was two paragraphs that required companies to quantify their risk and the effects of hedging arrangements, and disclose the effects of hedging on future cash flows. Stakeholders claimed these would require the disclosure of commercially sensitive information. Proprietary costs arguments are economic consequences arguments (Watts & Zimmerman, 1986). The IASB acknowledged complaints from preparers that the disclosures "would potentially provide competitors with insight into an entity's costing structure" (IASB, 2015j para. BC35X), and removed both paragraphs from the final standard. The greatest number of complaints across all exposure drafts concerned the increasing volume and cost of the disclosures, and these always had no effect. This is consistent with prior research that found economic consequences arguments ineffective (Giner & Arce, 2012).

8.6 Changes to the Characteristics of IFRS 7

This section presents the results of the fourth and final stage of the analysis explained in Section 6.3.5, the analysis of the changing characteristics of IFRS 7 over the period of analysis. Appendices C to F show the coding of disclosure items using the analytical constructs. Table 8.12 shows the number of new uniform, complex and commercially sensitive disclosure items in each exposure draft, and changes made by the IASB following public consultation.

The IASB initially added 22 new quantitative uniform disclosure items in its' four exposure drafts. One of the uniform disclosure items was withdrawn following public consultation and 17 new uniform disclosure items were added. Of six complex disclosure items proposed in the four exposure drafts, five were withdrawn following public consultation and none were added. Four commercially sensitive disclosure items were proposed in the exposure draft, ED/2010/13, and all were withdrawn following public consultation.

Table 8.12 Proposed and actual changes to IFRS 7 by analytical construct

IASB	TOTAL	ED7	ED/2008/10	ED/2009/3	ED/2010/13
Changes proposed in exposure draft					
Uniform disclosure added	39	7	8	11	13
Uniform disclosure (withdrawn)	(17)	(13)			(4)
Sub-total	22	(6)	8	11	9
Complex disclosure added	6	3	1	2	
Commercially sensitive disclosure added	4				4
Changes following public consultation					
Uniform disclosure added	17	3		1	13
Uniform disclosure (withdrawn)	(1)	(1)			
Sub-total	16	2		1	13
Complex disclosure (withdrawn)	(5)	(2)	(1)	(2)	
Commercially sensitive disclosure (withdrawn)	(4)				(4)

Note. This table reports information about the analytical constructs uniform disclosure, complex disclosure, and commercially sensitive disclosure, for amendments to disclosures in ED7, ED/2008/10, ED/2009/3, and ED/2010/13 before and after public consultation.

As shown in Table 8.13, over the period, uniform disclosures substantially increased, while complex and commercially sensitive disclosures did not.

Table 8.13 Summary of changes to IFRS 7 by analytical construct

IFRS 7	Uniform	Complex	Commercially sensitive
ED7	(4)	1	
ED/2008/10	8		
ED/2009/3	12		
ED/2010/13	22		
TOTAL	38	1	

Note. This table reports information about the analytical constructs uniform disclosure, complex disclosure, and commercially sensitive disclosure for ED7, ED/2008/10, ED/2009/3, and ED/2010/13.

8.7 Discussion

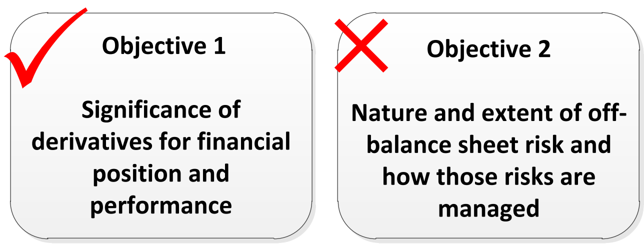
The objective of the third research question was to identify whether IFRS 7 is designed to meet the needs of users or preferences the needs of another stakeholder group. In order to achieve this, stakeholder preferences were identified from existing literature and confirmed over the ten years of the analysis. The following discussion addresses each stakeholder category separately and evaluates the results using literature from Chapter 4 and the lens of economic theories of regulation from Chapter 3.

8.7.1 Users

Users of financial information are the capital markets participants that rely upon publically available information to make resource allocation decisions (IASB, 2010a). Research has consistently shown that users do not participate strongly in the IASB's formal consultations, (Giner & Arce, 2012; Jorissen et al., 2012, 2013; Larson, 2007). This is confirmed in the present research that shows for the four exposure drafts, users submitted 11 letters or an average 2% of all comment letters.

Nevertheless, in a study of the UK standard setter, Georgiou (2010) found that for users, comment letters may not proxy participation via other channels, which can lead to research underestimating the extent of user participation. In 2003, the IASB set up its first formal user advisory group (Botzem & Quack, 2009). This Capital Markets Advisory Committee comprises 20 volunteer members, mainly financial analysts, representing a user perspective (IASB, 2015c). In recent years, the IASB has also begun publishing summaries of stakeholder outreach activities on its website, which makes it easier to discover user participation via the other channels identified by Georgiou. For example, in connection with the recently completed project on financial instruments, users were consulted on each phase of the project. Relevant to the present research, for the third phase on hedge accounting, the IASB communicated with over 30 individual analysts and two user groups: the Analyst Representative Group and the Corporate Reporting Users Forum (IASB, 2010c). Neither of these user groups submitted comment letters on the hedge accounting exposure draft. This makes it difficult to argue that users are the abstract concept of earlier times (Hopwood, 1994; Young, 2006) and would indicate the IASB has direct knowledge of what disclosures users want from IFRS 7.

The present research confirms that, as predicted, users lobby in favour of full and transparent disclosure (Table 8.6). There were no instances of a user suggesting less information was preferable to more information. In terms of the outcome of the standard setting process, users' needs are partly, but not fully, satisfied by developments in IFRS 7. As shown in Table 8.13, although the volume of uniform disclosures has substantially increased, few of the disclosures affecting derivatives in IFRS 7 are complex or commercially sensitive, which are both disclosure characteristics users value. For example, complex and commercially sensitive disclosures were requested by analysts in the IASB user outreach program on hedge accounting (IASB, 2010c para.23) and their requests were subsequently included in ED/2010/13 as paragraphs 45 and 46. Paragraphs 45 and 46 required the quantification of risk exposures and estimation of future cash flows associated with hedge accounting. During public consultation on ED/2010/13, users approved these paragraphs and asked that they be extended to include all risk management activities. This was connected to the second objective of IFRS 7 that requires companies to disclose information to enable users of financial statements to evaluate the nature and extent of risks arising from financial instruments.



This request for a more integrated, economic view of risk and risk management was also made in research conducted by practitioners (e.g. Ernst & Young, 2008; Papa & Peters, 2013) and was the request made by bank analysts in the first study when asked how the disclosures required by IFRS 7 could be improved. That both paragraph 45 and 46 were withdrawn by the IASB following public consultation demonstrates the influence of other interests.

Economic theories of regulation do not predict that users will be the main beneficiaries of standard setting, because compared to the regulated industries users have a lower individual stake in the product of regulation and are unlikely to place the highest value upon it. Users are diffuse and diverse and their preference for accounting information is not homogeneous. Evidenced by their low levels of participation, many users are free riders that do not share the cost of participation. Nevertheless, as a private sector standard setter with no governmental authority, transparent standard setting in the interests of users is a key element of the IASB's acceptability and legitimacy (Jorissen et al., 2012).

8.7.2 Preparers

Preparers are the large, often multi-national companies that prepare their accounts using international standards. They consistently submitted the majority of comment letters (Chatham et al., 2010; Giner & Arce, 2012; Hodder & Hopkins, 2014; Jorissen et al., 2012, 2013), which is suggestive of both the size of their stake and their expectation of being able to influence the outcome of the standard setting process (Sutton, 1984).

The few studies that have examined influence in international standard setting used data from before the widespread adoption of international standards. This was a time when the IASB and its predecessor the IASC, as private-sector standard setters with no elected or other governmental authority, were particularly reliant upon the participation of constituents as a key element of building and maintaining legitimacy (Kenny & Larson, 1993; Whittington, 2005). Taking this into account, earlier research has broadly found the development of international accounting standards to be a pluralistic process (Bamber & McMeeking, 2015; Giner & Arce, 2012), notwithstanding that preparers were most likely to secure changes to standards in accordance with their preferences (Cortese & Irvine, 2010; Kwok & Sharp, 2005). As Kwok and Sharp (2005, p. 95) observed, "in reality, it is difficult for the process to promulgate a standard adverse to the preferences of preparers."

The present research proposed and found that preparers objected to new disclosures that increase their processing costs or may require the exposure of commercially sensitive information. Drawing a distinction between uniform disclosures that increase processing costs, and specific complex disclosures that increase processing costs, more preparers objected to the large number of mainly uniform disclosures added to IFRS 7 over the period, than identified and objected to particular complex disclosures (Table 8.7). This distinction was unexpected, as complex disclosures are usually more costly than uniform disclosures, and may reflect the substantial increase in uniform disclosures throughout the period. Nevertheless, as shown in Table 8.12, following public consultation the IASB almost exclusively withdrew complex disclosures, while the overall volume of uniform disclosures increased, indicating that the preferences of preparers were partly met.

Economic theories of regulation do not predict that preparers will capture the regulatory process. The international standard setting process has two regulated groups with direct economic interests in the regulation: audit firms and preparers. Compared to audit firms, preparers have a lower individual stake in the product of regulation and are unlikely to place the highest value upon it. Preparers are also diffuse and diverse and their preference for accounting information is not homogeneous. For example, as shown in Table 8.8, the majority of non-financial companies rejected disclosures about risk exposures and future cash flows for hedged transactions, believing them commercially sensitive, while a majority of financial companies did not.

8.7.3 Audit firms

Audit firms are the Big 4 and second tier firms that contribute to the standard setting process. Prior to international harmonisation, there was a consensus that audit firms did not exhibit undue influence on standard setting organisations (at least, not on the FASB) (Kenny & Larson, 1993). However, this consensus disappeared with the rise of the IASC and IASB. Some researchers have focussed on the politics of international standard setting and believe it to be dominated by audit firms and the principle of expertise (Botzem & Quack, 2009; Cooper & Robson, 2006; Hopwood, 1994; Martinez-Diaz, 2005; Perry & Nölke, 2005; Suddaby et al., 2007). Through audit firms' ability to "define expertise" it is even argued that they have marginalised the accounting industry bodies that historically provided funding and support for the IASB (Botzem & Quack, 2009, p. 995). Only one empirical study has identified the influence of audit firms during public consultations and found the IASB is actually more likely to ignore the view of audit firms in its deliberations compared to other stakeholders (Bamber & McMeeking, 2015). However, this was a study of a single exposure draft and there remains a lack of evidence-based research.

The present research proposed and found that auditors lobby in their own economic interest. As shown in Table 8.9, support for the proposition auditors would support new uniform disclosure was strong, with 70% of audit firms supporting increased uniform disclosures. As explained in Section 4.5.3 auditors are expected to favour increased uniform disclosures as they lead to higher audit fees. Uniform disclosures are suited to the use of checklists which enable junior staff to perform more of the audit work (McBarnet, 2001; McBarnet & Whelan, 1991). Opposition to complex disclosure was also evident with 72% of objections to proposed disclosures identifying specific complex disclosures as a reason (Table 8.10). Complex disclosures have a higher risk of misstatement and are not suited to disclosure checklists, requiring an auditor to exercise judgement and have knowledge of the audit client.

Table 8.13 shows the volume of uniform disclosures has substantially increased since 2004. At the same time, five of six complex disclosure items proposed in the four exposure drafts were withdrawn by the IASB following public consultation (Table 8.12). Over time, IFRS 7 has therefore developed to suit the auditing professions' preference for uniform disclosure, with fewer disclosures that are complex.

Economic theories of regulation predict that audit firms are most likely to capture the standard setting process as Big 4 audit firms are small in number and homogeneous in their economic interests. They also have a large stake in the outcome of the standard setting process. In most countries listed companies prepare accounts in accordance with IFRS and the Big 4 firms audit most listed companies (Suddaby et al., 2007).

8.7.4 Regulators

Regulators are unlike other stakeholders, as they have no direct economic interest in the outcome of standard setting. They are the powerful outsiders admitted to the standard setting process (Stigler, 1971). Little research has focussed upon the influence of regulators in relation to the IASB although their role is both important and new in the context of supranational standard setting. Their role is important due to the place national standard setters hold, together with regional and supranational regulatory bodies, within the network of stakeholders that built, supported, and still surround the IASB (Zeff, 2012). Their role is new as for the first time national standard setting bodies are both stakeholders and lobbyists in the standard setting process.

The present research found regulators sometimes lobby in favour of full disclosure and transparency but take a preparer perspective when they believe that the cost of providing disclosure exceeds the benefit to the market (Table 8.11). This contradicts earlier research that found regulators made technical or conceptual arguments in their comment letters but not economic consequences arguments (Giner & Arce, 2014). This difference may reflect that the earlier research focussed upon recognition and measurement, or it may be the lobbying behaviour of regulators has changed since 2002, when data was collected for the earlier study. The latter view is consistent with the observation that as IFRS 7 has become longer and more prescriptive through time, regulators have increased their objections to proposed disclosures based on economic consequences (high processing costs).

Economic theories of regulation do not predict that regulators will capture the international standard setting process. Compared to other stakeholders, they have no direct economic interest and are unlikely to place the highest value upon the product. Indirectly, however, regulatory bodies are motivated by increasing their own power and wealth, so there may be times when individually, or in groups, regulators place a very high value upon a particular outcome. This occurred most recently during the 2007/8 financial crisis when standard setting for financial instruments became highly politicised. During the crisis, the FSB (2008) gave directions to the IASB that resulted in a rushed due process for two exposure drafts on financial instruments. Bengtsson (2011) has also documented the role of the European Union in forcing the IASB to waive due process on rules for valuing financial instruments in late 2008. The increased formalisation of the role of regulators since the financial crisis, described in Section 2.2, may serve to either increase or set the boundaries of future influence.

However, although these incidents show that regulators have power and will use it when an issue becomes sufficiently salient, this is not regulatory capture. Most of the time, regulators do not place the highest value on a specific outcome of the standard setting process, and due to their diversity, the cost of organisation would tend to preclude the formation of coalitions (Stigler, 1971). As the present research shows, regulators are not univocal in their lobbying and, consistent with earlier research (Giner & Arce, 2012), the IASB has shown no evidence of consistent or undue influence from regulators, whether they take a user perspective or a preparer perspective on any particular disclosure issue.

8.8 Implications

Table 8.14 shows how the economic interests of audit firms intersect across one (different) dimension for both users and preparers.

Table 8.14 Stakeholder disclosure preferences by analytical construct

Full disclosure	Users	Preparers	Audit firms
Uniform disclosure	Support	Oppose	Support
Complex disclosure	Support	Oppose	Oppose
Commercially sensitive disclosure	Support	Oppose	Support [a]

[a] Audit firms have no in principle opposition to commercially sensitive disclosures but will oppose them if they are complex.

Like users, audit firms strongly support increased uniform disclosures, and like preparers, tend to oppose complex disclosures. As shown in Table 8.13, in the ten years since IFRS 7 was proposed, the disclosure requirements for derivatives have developed to favour the economic interests of large audit firms with substantial increases in uniform disclosures. This finding is not inconsistent with earlier research that observed a pluralistic process or preparer influence, as examining influence over a short time-period cannot rule out longer term "patterns of outcomes … could more or less consistently support some specific interest above those of others" (Kwok & Sharp, 2005, p. 95).

As shown in Table 8.12, the pattern observed in this study is of increases in uniform disclosures, with some new complex or commercially sensitive disclosures proposed and withdrawn by the IASB following public consultation. This means that preparers tend to win on complex and commercially sensitive disclosures, but lose on quite large increases in uniform disclosures that increase their costs. At the same time, users are, to some extent, satisfied with the increase in uniform disclosures, but do not receive the complex or commercially sensitive disclosures they value. As Kwok and Sharp (2005, p. 95) observed, "other groups did not believe they lost out, since elements of their preferences were still in the final standard. In other words, the outcomes seemed to be a win-win situation to the different groups." This describes a pluralist understanding of international standard setting, where stakeholders believe different views must be accommodated within a framework none will deem perfect, but all can live with (Rescher, 1993). In this case, pluralism may not be the best explanation for the development of derivatives related disclosures in IFRS 7 that favour the economic interests of audit firms.

8.9 Summary

This chapter presented the results of the second study, which asked whether IFRS 7 was designed to meet the needs of users or was suited to the needs of a different stakeholder group. Chapter 9 draws conclusions from the results of the two studies presented in Chapter 7 and Chapter 8 to answer the overarching research objective, and identifies contributions, limitations, and opportunities for future research.

CHAPTER 9 DISCUSSION AND CONCLUSIONS

Chapter 8 set out the findings of the second study and completed this research. This chapter brings together the two studies that comprise the thesis to answer the overarching research objective and draw conclusions. Section 9.1 re-examines the research objective and Section 9.2 reviews the methodology and method. Section 9.3 discusses the findings of the two studies in the context of the overall research objective. Section 9.4 sets out the contribution of the research to accounting literature and practice. This is followed in Section 9.5 with the limitations of the research and Section 9.6 with opportunities for future research.

9.1 Research Objective

As explained in Chapter 1, financial engineering involving derivatives has challenged standard setters around the world to keep pace with new developments and their implications for reporting financial risk. That IFRS 7 had not properly reflected the transactions of multi-national investment banks was clear in the aftermath of the financial crisis of 2007/8. That financial scandals involving derivatives seem to take market by surprise was also indicative of a problem with the transparency of corporate disclosure. This led to the objective of this research: to explore whether the derivatives disclosures required by IFRS 7 provide users with information that is decision-useful, and to the extent that they do not, identify possible reasons.

Through academic and practitioner literature discussed in Chapter 4, possible reasons why the disclosures provided under IFRS 7 may not be useful to users were identified, and led to the research questions. First, there is evidence that companies implement the disclosure requirements for derivatives in a perfunctory and boilerplate way, although the extent to which financial statement users are adversely affected by poor disclosure quality was unknown. Similarly, archival research provided mixed evidence regarding the value-relevance or risk-relevance of quantitative disclosures required under IFRS 7, but did not evaluate the qualitative risk management disclosures, without which the quantitative disclosures lack context. Archival research also cannot identify whether a different disclosure would be more relevant to users than what is there. This would be indicative of a design issue with IFRS 7. The first two research questions addressed these limitations and were:

RQ1 Do the disclosures for derivatives made under IFRS 7 fulfil their purpose by meeting the decision making needs of users, and if not, why not?

RQ2 To the extent that the disclosures for derivatives required by IFRS 7 are not useful, what disclosures would be more useful?

A different strand of literature provided a different perspective, suggesting the disclosures for derivatives might not be decision-useful if IFRS 7 was not designed with users in mind. This would be the case if the standard setter had been 'captured' by one or more of its other stakeholders as predicted by economic theories of regulation. This possibility led to the third research question and sub-research question, which were:

RQ3 Are the disclosure requirements of IFRS 7 designed to meet the needs of users, or do they preference the needs of another stakeholder group?

SRQ3.1 What disclosure characteristics do different stakeholder groups prefer?

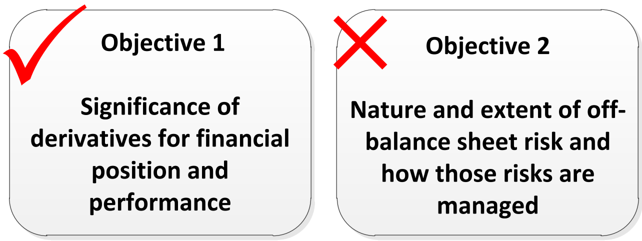
9.2 Methodology and Methods

As explained in Chapter 5, the theoretical perspective taken in this research was one of ontological realism and epistemological constructivism. The major contribution of Peircean pragmatism was to ground the research in an empirical mind-set, while using interpretive research methods suitable for exploratory research.

Two qualitative studies were undertaken to meet the research objective and are described in detail in Chapter 6. The first study answered the first two research questions using semi-structured interviews with analysts from Australia’s four largest banks. The second study answered the third research question and sub-research question through an analysis of IFRS 7 and related documents.

9.3 Discussion and Conclusions

Prior to conducting this research there were indications that the disclosures provided by companies about their derivative transactions may not be useful to users. If this was found to be the case, the objective of this research was to find a plausible reason or reasons. As explained in Section 4.1, IFRS 7 requires the disclosures for financial instruments to satisfy two broad objectives. The first objective is to provide users with an understanding of the significance of financial instruments for companies’ financial position and performance, that is, an explanation of recognised amounts. For derivatives, companies substantially meet this first objective. The second objective is to provide users with information about companies’ exposure to the risks associated with the recognised amounts, and to provide an understanding of why management enter into those risks and how they are managed. As explained in Section 2.1, risk reporting is particularly important for derivatives, and both of the studies that comprise this research indicated that the second objective is not met.



In order to meet the second objective of IFRS 7, companies provide narrative and summary quantitative disclosures for risk exposures arising from financial instruments based upon internal management reporting (IASB, 2005 para.33-34). Under this general provision, companies should explain the nature and source of the financial risks they are exposed to; management's objectives, policies, and processes for managing these risks; and provide sufficient quantitative information to support the narrative. In the case of derivatives, companies hold them as part of their policy for managing existing financial risks (hedging), or for speculation. Where derivatives are held for hedging, a company may or may not adopt hedge accounting and this can be disclosed under the general provisions. Therefore, in principle, IFRS 7 provides a flexible framework for companies to explain and quantify their financial risk. To the extent that companies do not voluntarily provide sufficient disclosures under the general provisions, IFRS 7 mandates a number of minimum disclosures such as a sensitivity analysis for market risk, maximum exposures for credit risk, and a maturity analysis for liquidity risk. While reporting flexibility has the advantage of allowing companies to provide information in a way that best reflects their use of financial instruments, it also makes it possible for companies to restrict information provided they meet the minimum disclosure requirements. As explained in Section 4.1, research has shown companies seem to take the latter option, with risk disclosures described as perfunctory and boilerplate.

Bank analysts interviewed in the first study confirmed that perfunctory and boilerplate explanations of risk management strategies and risk exposures were their primary dissatisfaction with existing disclosures. User demand for, and company resistance to, the disclosure of risk management strategies and risk exposures was also explicit in the second study. In outreach sessions prior to the issue of ED/2010/13 Hedge Accounting, users told the IASB they wanted more information on risk management and the effect of hedging on risk exposures (IASB, 2010c para.23). The IASB responded with paragraphs 44 and 45 of ED/2010/13. Paragraph 44 required a narrative description of risk management strategies and exposures where hedge accounting was adopted, and paragraph 45 required quantification of risk exposures before and after hedging. During public consultation on the exposure draft, users approved these (uniform) disclosures, as did a majority (70%) of audit firms. Preparers, especially non-financial firms, opposed paragraph 45 on the basis it required the disclosure of commercially sensitive information.

When ED/2010/13 asked what additional or different disclosures stakeholders would find useful for hedged transactions, all users, and 30% of audit firms, requested an extension of paragraph 44 and 45 to include all financial risk and economic hedges. Similar requests for a more integrated view of risk have been made in research conducted by practitioners (e.g. Ernst & Young, 2008; Papa & Peters, 2011; Papa & Peters, 2013). Bank analysts in the first study of this research also asked for this information when asked what additional or different disclosures they would like included in IFRS 7. The IASB rejected this request on the basis that it was outside the scope of IFRS 7; however, the IASB also noted individual companies have the option to provide this information under the general risk provisions (IASB, 2015j para.BC35J).

That paragraph 45 was withdrawn by the IASB following public consultation demonstrates the influence of preparers when the objection concerns commercially sensitivity. The IASB "acknowledged that [paragraph 45] would potentially provide competitors with insight into an entity's costing structure" and "decided not to require information to be disclosed about the total risk exposure because of the potential forward looking nature of this information" (IASB, 2015j para.BC35X). [33]

However, it is possible to question whether a uniform disclosure requiring quantification of risk exposures at year-end, even including disclosure of the hedged rate with its implications for future periods, is likely to cause significant competitive disadvantage. Further, losses companies incur from the disclosure of commercially sensitive information are proprietary costs and opposition to disclosure on this basis is an economic consequences argument. That this argument was accepted by the IASB is perhaps a reflection that proprietary costs are believed to be much "larger in proportion" than processing costs (Suijs, 2005, p. 1425). There is an alternative view, however, that proprietary costs are not costs, but are a consequence of providing the market with more nearly complete information (Schipper, 2010).

In either case, there is no clear evidence that proprietary costs affect disclosure practices (Beyer, Cohen, Lys, & Walther, 2010). However, there is evidence that companies conceal information for both proprietary motives and agency motives and that the two motives may be connected (Berger, 2011). Drawing upon bank analysts' comments in the first study, companies may not want to disclose their risk management strategies and quantify risk exposures because they believe competitors will use this information against them (a proprietary cost motive), or because they know that their risk management is inadequate, or more risky than the market knows (agency motives). It has even been suggested that the very

[33] Paragraph 45 was accompanied by paragraph 46, which required detailed breakdowns of the information in paragraph 45 for each future period that a hedging relationship covers. This was a complex disclosure, and as explained in Section 4.5.2, would usually be considered more commercially sensitive than a uniform disclosure such as paragraph 45.Users supported paragraph 46 (100%) while audit firms opposed it (57%). Paragraph 46 was withdrawn with paragraph 45.

plausibility of the proprietary cost argument allows agency motives to exist (Bens, Berger, & Monahan, 2011). That is, the proprietary cost argument provides ‘cover’ for companies that do not wish to disclose for other reasons. The decision of the IASB to withdraw a disclosure highly demanded by users based on a proprietary cost argument from preparers deserves further examination. This is especially the case given poor risk management practices were implicated in the 2007/8 financial crisis (Ryan, 2008) and other scandals involving derivatives. As Deegan (2014, p. 95) pointed out:

> Any consideration of possible economic consequences … necessarily involves a trade-off between the various consequences. For example, if neutrality/representational faithfulness are sacrificed to reduce potential negative impacts on some parties (for example, preparers who might otherwise have been required to disclose proprietary information …), this may have negative consequences for users seeking to make decisions on the basis of information provided.

The evidence, therefore, is that users want better information about companies risk management strategies and risk exposures. Although the second study concluded that IFRS 7 has evolved to suit the economic interests of audit firms, on this issue, audit firms supported uniform risk management and risk disclosures and their interests partly coincided with the interests of users. Companies’ resistance to providing informative disclosure ostensibly for reasons of commercial sensitivity, combined with the IASB’s reluctance to provide more prescriptive disclosure requirements in this area, may be the reason that the decision-usefulness of IFRS 7 is limited.

9.4 Contributions

The first study makes three contributions. First, this study extends the findings of empirical archival research and recent survey research that indicated preparers should prioritise their financial instrument disclosures. It extends this research by suggesting how preparers might increase user satisfaction without significantly increasing their processing costs. This could be achieved by providing more informative, company specific information about risk management policies and processes.

By providing bank analysts' insights into points of resistance by preparers to the provision of informative disclosures, a second contribution is made by suggesting ways in which the effectiveness of the IASB's recommendations on disclosures in ED/2015/3 Conceptual Framework for Financial Reporting might be enhanced for IFRS 7. In this exposure draft, the IASC reminds companies that "entity-specific information is more useful than 'boilerplate' language" (IASB, 2015d para.7.18).

The third contribution of the research is providing new evidence on the use and limitations of the disclosures for derivatives for credit-side analysts, a key user group about whose informational needs relatively little is known (Armstrong et al., 2010). Most notable is the extent to which the analysts focus upon qualitative disclosures. They use them to draw preliminary conclusions about the competence and sophistication of managements' risk strategies. They provide necessary context for quantitative disclosures. This study also supports calls from practice for companies to provide better information concerning their material economic risks.

The second study makes three contributions. First, the disclosure preferences of four key stakeholder groups were identified based upon expected economic incentives and tested over a ten-year period. This has increased knowledge about the disclosure preferences of stakeholders, particularly large audit firms and accounting regulators in the international standard setting arena. Where earlier research had shown that on matters of recognition and measurement, regulators and the accounting profession supported the preferences of users (Giner & Arce, 2012) for disclosure, this research shows distinct differences.

Second, lobbying research has identified international standard setting as a pluralistic process (Bamber & McMeeking, 2015; Giner & Arce, 2012), although preparers may have significant influence (Cortese & Irvine, 2010; Kwok & Sharp, 2005). However, it is a criticism of lobbying research that "each study tends to treat lobbying as a single-issue, single-period decision, when it actually may be a multiple-issue, multiple-period decision" (Kenny & Larson, 1993, p. 550). The present research takes into account changes over a longer period and is the first study to incorporate changes in disclosure initiated by the IASB. In doing so, it identifies that over the ten-year period, IFRS 7 has evolved to suit the preference of audit firms for uniform disclosures, and it is only because the economic interests of audit firms coincide with users and preparers that the standard setting process appears pluralistic.

Third, earlier research had found that the IASB responded to stakeholder lobbying that used conceptual or technical arguments, but did not respond to economic consequences arguments (Giner & Arce, 2012). The present research confirms the IASB is responsive to conceptual and technical arguments. However, although the IASB does not respond to complaints about the high processing cost of disclosure, they do respond to objections concerning the commercial sensitivity of disclosure, also an economic consequences argument.

The overarching research objective required an identification of the reasons why disclosures provided by companies under IFRS 7 may not be decision-useful. The research makes a practical contribution by identifying that poor disclosure quality around risk management and risk exposures are limiting the usefulness of derivatives disclosures under IFRS 7. It highlights to the IASB that these disclosures are strongly demanded by users and resisted by companies, particularly non-financial companies. It reminds the standard setter that when they make cost/benefit evaluations for new disclosures, proprietary cost motives may be mixed with agency motives. Potential proprietary costs should be considered in conjunction with the benefit of companies providing information to the market that is more complete.

9.5 Limitations

All research should be interpreted in light of its limitations. For the first study, the evidence comprised interviews with credit-side analysts across four major Australian banks. While these analysts were highly experienced in both derivatives and risk, their responses reflected their opinions and beliefs and may not be generalisable to all bank analysts or all users. However, given the experience of the analysts and the difficulty in gaining access to them, their views do expand knowledge in this area and highlight issues worthy of further research. Second, while the research questions were framed using the IASB's own construction of usefulness, the analysts were encouraged to discuss their own views within this framework. Although this approach benefits from its ability to identify what is most important to the people interviewed, rather than what is most important to the researcher, and while there was significant commonality across the analysts' views, not all analysts discussed or identified the same things, which reduces reliability. Third, the analysts' opinions regarding the reasons for companies' reliance upon generic disclosures, while based on direct experience with their clients, involved elements of speculation and should be interpreted accordingly.

For the second study, the evidence comprised an analysis of IFRS 7, exposure drafts, and comment letters over the ten-year period from 2004 to 2014. While addressing limitations of earlier research that examined influence for a single issue or single exposure draft, this study examined the disclosure requirements of one standard. It is therefore unknown if results are generalisable to other standards. The method of manual coding and analysis used in this study required the researcher to apply technical knowledge to be able to interpret the meaning of often lengthy comments, which was time consuming and involved judgement. This has implications for reliability. Linked to this, the detailed level of the analysis made statistical methods less employable and the results of the analysis less robust.

9.6 Future Research

Several avenues for future research are suggested by the results of this research. First, the results of the first study suggest the development of a survey to test ideas raised by the analysts. The views of audit firms on their clients' use of boilerplate disclosures would be one example, and could be compared to the views of companies. The question of commercial sensitivity that arose in both studies could be addressed with either interviews or survey methods.

Second, lobbying research that examines stakeholder influence has, to date, analysed changes in discussion papers and exposure drafts over a short period. Although this was necessary during the early years of the IASB, it is now possible to address this limitation. It is also important for lobbying research to take into account changes initiated by the IASB, if the goal is to identify indirect, as well as direct influence. An economic incentives approach reduces the impact of researcher bias in interpreting changes to standards by making underlying assumptions explicit. Accordingly, future research should evaluate a second disclosure standard to determine if the results of this research are generalisable. A similar, longitudinal economic incentives approach could help to understand influence on standards concerned with recognition and measurement.

Third, more evidence based research on the lobbying behaviour of regulators is warranted given their importance in the international standard setting framework. Existing research combines national and supranational regulators and has found they support users (Giner & Arce, 2012). The present research has found that this is not always the case. In the same way, audit firms and accounting industry bodies have previously been found to support users (Giner & Arce, 2012; Saemann, 1999), which deserves further analysis as their views may have changed or may not be univocal. Country differences may be relevant, as these stakeholder categories are likely to include respondents that represent national interests.

Fourth, how the IASB evaluates cost/benefit should be further investigated, including how it evaluates proprietary cost arguments by preparers. Although the issue of cost/benefit in standard setting has been discussed (e.g. Schipper, 2010), there is a lack of evidence based research.

9.7 Summary

This chapter concludes the PhD thesis titled: An Exploration of the Usefulness of the Disclosures for Derivatives in Company Annual Reports. Chapter 9 summarised the motivation for this research and identified the research questions derived from academic and other literature. This chapter brought together the findings from two separate qualitative studies to answer the overarching research objective. Contributions and limitations were then discussed and opportunities for future research identified.

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Appendix A History of IFRS 7

Date	Development	Comment
July 2004	Exposure Draft ED 7 *Financial Instruments: Disclosures*	Proposed new standard
August 2005	IFRS 7 *Financial Instruments: Disclosures* issued	Effective 1 January 2007
October 2008	Amendment *Reclassification of Financial Assets* (*Amendments to IAS 39 and IFRS 7)*	Applies to non-derivative assets. Effective 1 July 2008 (no exposure draft)
October 2008	Exposure draft ED/2008/10 *Improving disclosures about financial instruments*	Three level fair value hierarchy and liquidity risk
March 2009	Amendment *Improving Disclosures about Financial Instruments (Amendments to IFRS 7)*	Effective 1 January 2009 (backdated)
December 2008	Exposure Draft *Investments in Debt Instruments (proposed amendments to IFRS7)*	Applies to non-derivative liabilities. Withdrawn January 2009
August 2009	Exposure draft ED/2009/11 *Improvements to IFRSs*	Clarifications and minor amendments
May 2010	Amendment *Improvements to IFRSs (clarification of disclosures)*	Effective 1 January 2011
April 2009	Exposure draft ED/2009/3 *Derecognition*	Derecognised assets with continuing exposure
October 2010	*Disclosures – Transfers of Financial Assets (Amendments to IFRS 7)*	Effective 1 July 2011
December 2010	Exposure draft ED/2010/13 *Hedge Accounting*	New hedge accounting model and disclosures
November 2013	Amendments *IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)*	Effective January 2018 or when IFRS 9 first applied
January 2011	Exposure draft ED/2011/1 *Offsetting Financial Assets and Financial Liabilities*	Netting of financial assets and liabilities
December 2011	*Amendment Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7*	Effective 1 January 2013
August 2011	Exposure draft ED/2011/3 *Mandatory Effective date of IFRS 9*	Effective date of IFRS 9
December 2011	*Mandatory Effective Date and Transition Disclosures (Amendments to IFRS 9 and IFRS 7)*	Effective 1 January 2015 or when IFRS 9 first applied
December 2013	Exposure draft ED/2013/11 *Annual Improvements to IFRSs 2012/14 cycle*	Servicing contracts and applicability of IFRS 7 to condensed interim financial statements
September 2014	Amendments *Improvements to IFRSs 2012-2014*	Effective January 2016

Note. This table shows all amendments to IFRS from the initial exposure draft, ED 7 to January 2015. Exposure drafts that substantially affect the disclosure of derivatives are highlighted.

Appendix B Interview guide

Background information

- How long have you worked as an analyst and in what kind of roles?
- What companies or sectors do you mainly work with?
- What is your particular interest in or experience with derivatives?

1. To what extent do the disclosures in annual reports allow you to (a) evaluate the significance of derivatives to an entity's financial position and performance, (b) understand the nature and extent of their risk, and (c) understand an entity's practices and processes for managing that risk? (RQ1)

2. How do you think the disclosures required by IFRS 7 for derivatives could be improved, if at all i.e. disclosures not currently required under IFRS 7? (RQ2)

Appendix C IAS 32, ED 7 and IFRS 7

Current requirements of IFRS 7 (2015)	IAS 32 (2004)	ED 7 (2004)	AC [a]	IFRS 7 (2005)	AC [a]
Significance for financial position and performance					
Carrying amount for items mandatorily recognised at FV, either line item in the balance sheet or in the notes (para.8)		Yes (para.10)	*+U*	Yes (para.8)	
Gains and losses for items mandatorily recognised at FV, either line item in the P&L or in the notes (para.20)		Yes (para.21)	*+U*	Yes (para.20)	
Terms and conditions of instruments	**Para.60-66**				
	For each class of instrument, the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows (para.60)				
	For each class, whether trade or settlement date accounting is used (para.61)		*-U*		
	If no single instrument is individually significant to the future cash flows of the entity, the essential characteristics of the instruments are Described (para.62)		-N		
	When financial instruments either individually or as a class, create a potentially significant risk exposure the following terms and conditions are disclosed (para.63): - The principal, face or notional value - date of maturity, expiry or execution - availability of early settlement options - option to convert or exchange and timing - amount and timing of scheduled		 *-U* *-U* *-U* *-U*		

Current requirements of IFRS 7 (2015)	IAS 32 (2004)	ED 7 (2004)	AC [a]	IFRS 7 (2005)	AC [a]
	future cash receipts or payments of the principal		*-U*		
	- stated rate or amount of any periodic return on principal and the timing of payments		*-U*		
	- collateral		*-U*		
	- any foreign currency cash flows		*-U*		
	- where an instrument is acquired in an exchange, the above information for the instrument acquired		*-U*		
	- significant conditions or covenants		*-U*		
	When the balance sheet presentation of a financial instrument differs from the instrument's legal form, it is desirable for an entity to explain in the notes the nature of the instrument. (para.64)		*-N*		
	The extent to which a risk exposure is altered by the relationship among the assets and liabilities may be apparent to financial statement users from information of the type described in paragraph 63, but in some circumstances further disclosure is necessary (para.65)		*-N*		
Hedge disclosures (para.22-24)	**(para.56-59)**	**(para.24-25)**		**(para.22-23)**	
	An entity shall <u>describe</u> its financial risk management objectives and policies, including its policy for hedging each main type of forecast transaction for which hedge accounting is used (para.56)		*-N*		
An entity shall disclose the following separately for each type of hedge described in IAS 39 (i.e. fair value hedges, cash flow hedges, and hedges of net investments in	Yes (para.58)	Yes (para.24)		Yes (para.22)	

Current requirements of IFRS 7 (2015)	IAS 32 (2004)	ED 7 (2004)	AC [a]	IFRS 7 (2005)	AC [a]
foreign operations):					
- a description of each type of hedge	Yes	Yes		Yes	
- a description of the financial instruments designated as hedging instruments and their fair values at the end of the reporting period	Yes	Yes		Yes	
- the nature of the risks being hedged	Yes	Yes		Yes	
For cashflow hedges the following is disclosed:					
- the periods when the cash flows are expected to occur and when they are expected to affect profit or loss	Yes	Yes		Yes	
- a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur	Yes	Yes		Yes	
- the amount that was recognised in other comprehensive income during the period (or taken to equity pre OCI statements)	Yes	Yes		Yes	
- the amount that was reclassified from equity to profit or loss for the period, showing the amount included in each line item in the statement of comprehensive income	Yes	Yes		Yes	
- the amount that was removed from equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a	Yes	Yes		Yes	

Current requirements of IFRS 7 (2015)	IAS 32 (2004)	ED 7 (2004)	AC [a]	IFRS 7 (2005)	AC [a]
hedged highly probable forecast transaction					
Additional hedge disclosures:				**(para.24)**	
- in fair value hedges, gains or losses on the hedging instrument and on the hedged item attributable to the hedged risk				Yes	+*U*
- the ineffectiveness recognised in profit or loss that arises from cash flow hedges				Yes	+*U*
- the ineffectiveness recognised in profit or loss that arises from hedges of net investments in foreign operations				Yes	+*U*
Nature and extent of financial risks arising from financial instruments					
Qualitative disclosures (para 33)		**(para.34)**		**(para.33)**	
Disclose for each financial risk:					
- nature of the exposures to risk and how they arise (by risk)		Yes	+*N*	Yes	
- objectives, policies and processes for managing the risk and the methods used to measure the risk		Yes	+*N*	Yes	
- any changes to the above from the previous period		Yes	+*N*	Yes	
Providing qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture					
Quantitative disclosures (para.34)		**(para.35-45)**		**(para.34-35)**	
Disclose for each financial risk:					
- summary quantitative data about each		Yes (para.35)	+*U*	Yes (para.34)	

Current requirements of IFRS 7 (2015)	IAS 32 (2004)	ED 7 (2004)	AC [a]	IFRS 7 (2005)	AC [a]
exposure at the end of the reporting period based upon information provided internally e.g. to the board and CEO					
- if the quantitative data disclosed as at the end of the reporting period are unrepresentative of an entity's exposure to risk during the period, an entity shall provide further information that is representative		Yes (para.36)	+*U*	Yes (para.35)	
		When an entity uses several methodologies in managing a risk exposure, the entity shall disclose information using the method(s) that provide the most relevant and reliable information (para.37)	+*N*		-*N*
- quantitative information on concentrations (if not provided below)	Yes (76(b))	Yes (para.35)	+*U*	Yes (para.34)	
- explanation of how management determines concentrations		Yes (para.38)	+*N*		-*N*
		A description of shared characteristic that determines concentrations (para.38)	+*N*		-*N*
		The amount of risk exposure for all financial instruments that share that characteristic (para.38)	+*U*		-*U*
Credit risk (para.36)	**(para.76-85)**	**(para.39-41)**		**(para.36-38)**	
- maximum exposure to credit risk excluding collateral or other credit enhancements, and information about credit quality	Yes (para.76(a))	Yes (para.39(a))		Yes (para.36)	

Current requirements of IFRS 7 (2015)	**IAS 32 (2004)**	**ED 7 (2004)**	**AC [a]**	**IFRS 7 (2005)**	**AC [a]**
- information about collateral		Yes – plus fair value of collateral unless impracticable (para.39(b))	*+N* *+C*	Yes (para.36)	*-C*
- information about credit quality on assets neither past due or impaired		Yes (para.39(c))	*+N*	Yes	
Liquidity risk (para.39)		**(para.42)**		**(para.39)**	
- a maturity analysis for financial liabilities that shows the remaining contractual maturities		Yes	*+U*	Yes	
- a maturity analysis for derivative financial liabilities					
- a description of how liquidity risk is managed		Yes	*+N*	Yes	
Market risks (para.40-42)		**(para.43-45)**		**(para.40-42)**	
	Interest rate risk (para.67). – Contractual maturity/re-pricing dates – Effective interest rates – Optional sensitivity analysis; and expected maturity/re-pricing dates		*-U* *-U*		
- a sensitivity analysis for each type of market risk variable to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date		Yes	*+C*	Yes	
- the methods and assumptions used in preparing the sensitivity analysis		Yes	*+N*	Yes	
- changes from the previous period in		Yes	*+N*	Yes	

Current requirements of IFRS 7 (2015)	IAS 32 (2004)	ED 7 (2004)	AC [a]	IFRS 7 (2005)	AC [a]
the methods and assumptions used, and the reasons for such changes					
When the sensitivity analyses are unrepresentative of a risk inherent in a financial instrument (for example because the year-end exposure does not reflect the exposure during the year), the entity shall disclose that fact and the reason it believes the sensitivity analyses are unrepresentative		When the sensitivity analysis is unrepresentative of a risk inherent in a financial instrument that risk should be explained <u>and quantified</u> (para.45)	*+C*	Yes – explain only	*-C* *+N*

Note. Disclosures relevant to derivative financial instruments and affected by the applicable exposure draft are shown. All versions of IFRS 7 are from the IASB's blue book, which does not include any amendments that are not yet effective. [a] AC = analytical construct. Each disclosure proposed in the exposure draft and subsequently adopted or withdrawn is coded as U = uniform, C = complex or CS = commercially sensitive. Narrative disclosures are coded 'N' for information purposes. Objectives or non-operational paragraphs are not included in the analysis.

Appendix D IFRS 7 before and after exposure draft ED/2008/10

Fair value disclosures, IFRS 7 (2015) and IFRS 13 (2015)	IFRS 7 (2009)	ED/2008/10	AC [a]	IFRS 7 (2010)	AC[a]
IFRS 7 (para.25-30)	**(para.25-30)**				
Except as set out below, for each class of financial assets and financial liabilities, an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount (para.25)	Yes (para.25)	Yes (para.25)		Yes (para.25)	
Disclosures of fair value are not required for an investment in equity instruments that do not have a quoted price in an active market for an identical instrument (i.e. a Level 1 input), or **derivatives** linked to such equity instruments, that is measured at cost in accordance with IAS 39 because its fair value cannot otherwise be measured reliably (para.29)	Yes (para.29)	Yes (para.29)		Yes (para.29)	
In the cases described above an entity shall disclose information to help users of the financial statements make their own judgments about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value (para.30)	Yes (para.30)	Yes (para.30)		Yes (para.30)	
IFRS 13 (para.90-99)					
In some cases, the inputs used to measure the fair value of an asset or a liability might be categorised within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input (i.e. least observable) that is significant to the entire measurement (para.73)		Yes (para.27A)		Yes (para.27A)	
An entity shall disclose information that helps users of its financial statements assess both of the following (para.91):					
- the valuation techniques and inputs used to	Yes (para.27)	Yes (para.27)		Yes (para.27)	

Fair value disclosures, IFRS 7 (2015) and IFRS 13 (2015)	**IFRS 7 (2009)**	**ED/2008/10**	**AC [a]**	**IFRS 7 (2010)**	**AC[a]**
develop fair value measurements					
- for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period	Yes (para.27)	Yes (para.27)		Yes (para.27)	
To meet the objectives in paragraph 91, an entity shall consider all the following (para.92):					
- the level of detail necessary to satisfy the disclosure requirements	Yes (para.B3 mandatory application guidance)	Yes (para.B3 mandatory application guidance)		Yes (para.B3 mandatory application guidance)	
- how much emphasis to place on each of the various requirements	Yes (para.B3 mandatory application guidance)	Yes (para.B3 mandatory application guidance)		Yes (para.B3 mandatory application guidance)	
- how much aggregation or disaggregation to undertake	Yes (para.B3 mandatory application guidance)	Yes (para.B3 mandatory application guidance)		Yes (para.B3 mandatory application guidance)	
- whether users of financial statements need additional information to evaluate the quantitative information disclosed	Yes (para.B3 mandatory application guidance)	Yes (para.B3 mandatory application guidance)		Yes (para.B3 mandatory application guidance)	
If the disclosures provided in accordance with this IFRS and other IFRSs are insufficient to meet the objectives in paragraph 91, an entity shall disclose additional information necessary to meet those objectives	Yes – objectives of standards (para.7 & 31)	Yes – objectives of standards (para.7 & 31)		Yes – objectives of standards (para.7 & 31)	
To meet the two objectives in para.91, the following must be disclosed at a minimum (para.93):					
- the fair value measurement at the end of the reporting period	Yes (para.25)	Yes (para.25)		Yes (para.25)	
- the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3)		Yes (para.27B(a))	+*U*	Yes (para.27B(a))	
- the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the entity's		Yes (para.27B(e))	+*U*	Yes (para.27B(b))	

Fair value disclosures, IFRS 7 (2015) and IFRS 13 (2015)	**IFRS 7 (2009)**	**ED/2008/10**	**AC [a]**	**IFRS 7 (2010)**	**AC[a]**
policy for determining when transfers between levels are deemed to have occurred					
Additionally, for fair value measurements categorised within **Level 2 and Level 3** of the fair value hierarchy (para93(c)(d)): - a description of the valuation technique and the inputs used in the fair value measurement	Yes (para.27)	Yes (para.27)		Yes (para.27)	
- if there has been a change in valuation technique (e.g. changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it		Yes (para.27)	*+U*	Yes (para.27)	
- for fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement					
- an entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (e.g. when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity					
Additionally **for fair value measurements categorised within Level 3 of the fair value hierarchy** (para93(e)):					

Fair value disclosures, IFRS 7 (2015) and IFRS 13 (2015)	**IFRS 7 (2009)**	**ED/2008/10**	**AC [a]**	**IFRS 7 (2010)**	**AC[a]**
A reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:		Yes (para.27B(b))		Yes (para.27B(c))	
- total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised		Yes	+*U*	Yes	
- total gains or losses for the period recognised in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognised		Yes	+*U*	Yes	
- purchases, sales, issues and settlements (each of those types of changes disclosed separately)		Yes - shown net (para.27B (b)(iii))	+*U*	Yes – shown gross (para.27B (b)(iii))	
- the amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred. Significant movements shown gross.		Yes – shown net (para. 27B(b)(iv)) Reasons and policies para.27B(e)	+*U*	Yes –shown gross (para.27B (b)(iv)) Reasons and policies now in this section	
For recurring fair value measurements categorised within Level 3 of the fair value hierarchy the amount of the total unrealised gains or losses for the period in included in profit or loss (para.93(f))	Total gains and losses for items held at end of period (para.27(d))	Total unrealised gains or losses for the period in included in profit or loss (para.27B(c))	+*C*	Total gains and losses for items held at end of period (para.27B(d))	-*C*
For recurring and non-recurring fair value measurements categorised within Level 3 of the fair value hierarchy description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period (para.93(g))					
For recurring fair value measurements categorised within Level 3 of the fair value hierarchy (para.93(h))					

Fair value disclosures, IFRS 7 (2015) and IFRS 13 (2015)	**IFRS 7 (2009)**	**ED/2008/10**	**AC [a]**	**IFRS 7 (2010)**	**AC[a]**
− A narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if such changes may be significant (para.93(h)(i))					
− If changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes (para.93(h)(ii))	Yes (para.27)	Yes (para.27B(d))		Yes (para.27B(e))	
An entity shall present the quantitative disclosures required by this IFRS in a tabular format unless another format is more appropriate (para.99)		Yes (para.27B)		Yes (para.27B)	
Nature and extent of financial risks arising from financial instruments					
Liquidity risk (para.39)					
An entity shall provide a maturity analysis for derivative financial liabilities. Include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows	Maturity analysis with contractual maturities required for all financial liabilities (para.39(a)	A maturity analysis for derivative financial liabilities based upon how management manage liquidity risk (para.39(a))	*+U*	An entity shall provide a maturity analysis for derivative financial liabilities. Include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (para.39(b))	
- a description of how liquidity risk is managed	Yes	Yes		Yes	

Note. Disclosures relevant to derivative financial instruments and affected by the applicable exposure draft are shown. The fair value disclosures from IFRS 7 moved to IFRS 13 effective from January 2013 except for scope exceptions that remain in IFRS 7. All versions of IFRS 7 are from the IASB's blue book, which does not include any amendments that are not yet effective. [a] AC = analytical construct. Each disclosure proposed in the exposure draft and subsequently adopted or withdrawn is coded as U = uniform, C = complex or CS = commercially sensitive. Narrative disclosures are coded 'N' for information purposes. Objectives or non-operational paragraphs are not included in the analysis.

Appendix E IFRS 7 before and after exposure draft ED/2009/3

Current requirements of IFRS 7 (2015)	IFRS 7 (2009)	ED/2009/3	AC [a]	IFRS 7 (2012)	AC [a]
Transfers (para.42)	**(para.13)**	**(para.42A-H)**		**(para.42A-H)**	
An entity shall provide the required disclosures for **all transferred financial assets that are not derecognised and for any continuing involvement** in a transferred asset, existing at the reporting date, irrespective of when the related transfer transaction occurred				Yes (para.42A)	
For the purposes of applying the disclosure requirements in those paragraphs, an entity transfers all or a part of a financial asset (the transferred financial asset) if, and only if, it either				Yes (para.42A)	
– transfers the contractual rights to receive the cash flows of that financial asset				Yes (para.42A(a))	
– retains the contractual rights to receive the cash flows of that financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement.				Yes (para.42A(b))	
An entity shall disclose information that enables users of its financial statements: - to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; - to evaluate the nature of, and risks associated with, the entity's continuing involvement in **derecognised** financial assets				Yes (para.42B(a)) Yes (para.42B(b))	
For the purposes of applying the disclosure requirements in paragraphs 42E–42H, an entity has continuing involvement in a transferred financial asset if, as part of the transfer, the entity retains any of the contractual rights or obligations inherent in		Yes (para.42C)		Yes (para.42C)	

Current requirements of IFRS 7 (2015)	IFRS 7 (2009)	ED/2009/3	AC [a]	IFRS 7 (2012)	AC [a]
the transferred financial asset or obtains any new contractual rights or obligations relating to the transferred financial asset.					
An entity may have transferred financial assets in such a way that **part or all of the transferred financial assets do not qualify for derecognition**. The entity shall disclose at each reporting date for each class of transferred financial assets that are not derecognised in their entirety:	Yes (para.13)	Yes (para.42B)		Yes (para.42D)	
- the nature of the transferred assets	Yes (para.13(a))	Yes (para.42B(a))	+*N*	Yes (para.42D(a))	
- the nature of the risks and rewards of ownership to which the entity is exposed	Yes (para.13b))	Yes (para.42B(b))	+*N*	Yes (para.42D(b))	
- a description of the nature of the relationship between the transferred assets and the associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets		Yes (para.42B(d))	+*N*	Yes (para.42D(c))	
- when the counterparty to the associated liabilities has recourse only to the transferred assets, a schedule that sets out the fair value of the transferred assets, the fair value of the associated liabilities and the net position (the difference between the fair value of the transferred assets and the associated liabilities).		Yes (para.42B(e))	+*U*	Yes (para.42D(d))	
- when the entity continues to recognise all of the transferred assets, the carrying amounts of the transferred assets and the associated liabilities	Yes (para.13c))	Yes (para.42B(c))		Yes (para.42D(e))	
- when the entity continues to recognise the assets to the extent of its continuing involvement the total carrying amount of the original assets before the transfer, the carrying amount of the assets that the entity continues to recognise, and the	Part – just remaining carrying amount (para.13d))	Part – just remaining carrying amount (para.42B(c))		Yes (para.42D(f))	+*U*

Current requirements of IFRS 7 (2015)	IFRS 7 (2009)	ED/2009/3	AC [a]	IFRS 7 (2012)	AC [a]
carrying amount of the associated liabilities					
When an entity **derecognises transferred financial assets in their entirety but has continuing involvement in them**, the entity shall disclose, as a minimum, for each type of continuing involvement at each reporting date:		Yes (para.42D)		Yes (para.42E)	
- the carrying amount of the assets and liabilities that are recognised in the entity's statement of financial position and represent the entity's continuing involvement in the derecognised financial assets, and the line items in which the carrying amount of those assets and liabilities are recognised		Yes (para.42D(a))	+*U*	Yes (para.42E(a))	
- the fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognised financial assets.		Yes (para.42D(b))	+*U*	Yes (para.42E(b))	
- the amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognised financial assets, and information showing how the maximum exposure to loss is determined		Yes (para.42D(c))	+*U*	Yes (para.42E(c))	
		The FV of derecognised financial assets in which the entity has a continuing involvement, including a description of the methods and assumptions applied in determining fair value (para.42D(d))	+*C*		-*C*
- the undiscounted cash outflows that would or may be required to repurchase derecognised financial assets (e.g. the strike price in an option agreement) or		Yes (para.42D(e))	+*U*	Yes (para.42E(d))	

Current requirements of IFRS 7 (2015)	IFRS 7 (2009)	ED/2009/3	AC [a]	IFRS 7 (2012)	AC [a]
other amounts payable to the transferee in respect of the transferred assets. If the cash outflow is variable then the amount disclosed should be based on the conditions that exist at each reporting date					
- a maturity analysis of the undiscounted cash outflows that would or may be required to repurchase the derecognised financial assets or other amounts payable to the transferee in respect of the transferred assets, showing the remaining contractual maturities of the entity's continuing involvement.		Yes (para.42D(f))	+*U*	Yes (para.42E(3))	
		A sensitivity analysis showing the possible effect on the FV of the continuing involvement in the risk variables reasonably possible at reporting date Describe methods and assumptions for sensitivity analysis (para.42D(g))	+*C*		-*C*
- qualitative information that explains and supports the quantitative disclosures required above		Yes (para.42D(h))	+*N*	Yes (para.42E(f))	
- An entity may aggregate the information required above				Yes (para.42F)	
In addition, an entity shall disclose for each type of continuing involvement:		Yes (para.42E)		Yes (para.42G)	
– the gain or loss recognised at the date of transfer of the assets		Yes (para.42E(a))	+*U*	Yes (para.42G(a))	
- income and expenses recognised, both in the reporting period and cumulatively, from the entity's continuing involvement in the derecognised financial assets (e.g. fair value changes in derivative		Yes (para.42E(b))	+*U*	Yes (para.42G(b))	

Current requirements of IFRS 7 (2015)	IFRS 7 (2009)	ED/2009/3	AC [a]	IFRS 7 (2012)	AC [a]
instruments					
If the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period is not evenly distributed throughout the reporting period (e.g. if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period):		Yes (para.42E(c))		Yes (para.42G(c))	
- when the greatest transfer activity took place within that reporting period (e.g. the last five days before the end of the reporting period),		Yes (para.42E(c))	+*U*	Yes (para.42G(c))	
- the amount (e.g. related gains or losses) recognised from transfer activity in that part of the reporting period, and		Yes (para.42E(c))	+*U*	Yes (para.42G(c))	
- the total amount of proceeds from transfer activity in that part of the reporting period.		Yes (para.42E(c))	+*U*	Yes (para.42G(c))	
An entity shall disclose any additional information that it considers necessary to meet the disclosure objectives of enabling users of its financial statements to understand the relationship between transferred financial assets not derecognised in their entirety and the associated liabilities; and to evaluate the nature of, and risks associated with, the entities continuing involvement in derecognised financial assets.		Yes (para.42F)	+*N*	Yes (para.42H)	

Note. Disclosures relevant to derivative financial instruments and affected by the applicable exposure draft are shown. All versions of IFRS 7 are from the IASB's blue book, which does not include any amendments that are not yet effective. [a] AC = analytical construct. Each disclosure proposed in the exposure draft and subsequently adopted or withdrawn is coded as U = uniform, C = complex or CS = commercially sensitive. Narrative disclosures are coded 'N' for information purposes. Objectives or non-operational paragraphs are not included in the analysis.

Appendix F IFRS 7 before and after exposure draft ED/2010/13

IFRS 7 (2010)	ED/2010/13 Hedge accounting	AC [a]	IFRS 7 (effective 2018)	AC [a]
Hedge accounting (para.22-24)				
An entity shall disclose the following separately for each type of hedge described in IAS 39 (para.22)				
- a description of each type of hedge		*-N*		
- a description of the financial instruments designated as hedging instruments and their fair values at the end of the reporting period; and		*-U*		
- the nature of the risks being hedged		*-N*		
	Objectives (para.40)		**(para. 21)**	
	An entity shall **apply the disclosure requirements to those risk exposures** that an entity hedges and for which it elects to apply hedge accounting		Yes	
	1. an entity's **risk management strategy** and **how it is applied** to manage risk		Yes	
	2. how the entity's **hedging activities** may affect the **amount, timing and uncertainty of its future cash flows**		Yes	
	3. the **effect that hedge accounting** has had on the entity's **position and results**		Yes	
	Can do in a single note or by cross reference (para.41)		Yes	
	Entity shall identify risk categories based on the risk exposures it decides to hedge and for which hedge accounting is applied. Risk categories must be consistent for all hedge accounting disclosures (para.42)		Yes	
	An entity can determine the level of aggregation it thinks appropriate but must be consistent with other IFRS 7 and IFRS 13 disclosures (para.43)		Yes	

IFRS 7 (2010)	ED/2010/13 Hedge accounting	AC [a]	IFRS 7 (effective 2018)	AC [a]
	Risk management strategy (para.44)		**(para. 22)**	
	An entity shall explain its risk management strategy for each risk category of risk exposures that it decides to hedge and for which hedge accounting is applied, including:		Yes	
	- how each risk arises	+*N*	Yes	
	- how the entity manages each risk; this includes whether the entity hedges an item in its entirety for all risks or hedges a risk component (or components) of an item and why	+*N*	Yes	
	- the extent of risk exposures that the entity manages	+*N*	Yes	
			As part of the risk management discussion required above, an entity must include (but not limited to):	
			- the hedging instruments that are used (and how they are used)	+*N*
			- how the entity determines the economic relationship between the hedged item and the hedging instrument for the purpose of assessing hedge effectiveness	+*N*
			- how the entity establishes the hedge ratio and what the sources of hedge ineffectiveness are	+*N*
			When an entity designates a specific risk component (a component comprises less than the entire fair value change or cash flow variability of an item), as a hedged item, it shall provide, in addition to the disclosures required in 22A and 22B <u>qualitative or quantitative</u> information about:	
			- how the entity determined the risk component that is designated	+*N*

IFRS 7 (2010)	ED/2010/13 Hedge accounting	AC [a]	IFRS 7 (effective 2018)	AC [a]
			as the hedged item (including a description of the nature of the relationship between the risk component and the item as a whole	
			- how the risk component relates to the item in its entirety e.g. the designated risk component historically covered on average 80 per cent of the changes in fair value of the item as a whole	*+N*
	The amount, timing and uncertainty of future cash flows (para.45-48)		**(para. 23)**	
For cash flow hedges, the periods when the cash flows are expected to occur and when they are expected to affect profit or loss (para.23(a))				
	For each category of risk exposure, an entity shall disclose quantitative information to enable users to evaluate the types of risk exposures being managed in each risk category, the extent to which each type of exposure is hedged and the effect of the hedging strategy on each type of risk exposure (para.45)	*+CS*	No	*-CS*
	An entity shall provide a breakdown for each subsequent period that the hedging relationship is expected to affect profit, the following (para.46)		No	
	- the monetary amount or other quantity to which the entity is exposed for each particular risk	*+CS*	No	*-CS*
	- the amount or quantity of the exposure being hedged	*+CS*	No	*-CS*
	- in quantitative terms how the hedging changes the exposure	*+CS*	No	*-CS*
			Unless exempted by para. 23C, an entity shall disclose by risk category quantitative information to allow	

IFRS 7 (2010)	ED/2010/13 Hedge accounting	AC [a]	IFRS 7 (effective 2018)	AC [a]
			users of its financial statements to evaluate the terms and conditions of hedging instruments and how they affect the amount, timing and uncertainty of future cash flows of the entity (para.23A)	
			To meet the requirements above they must provide a breakdown that includes (para 23B):	
			- a profile of the timing of the nominal amount of the hedging instrument	+*U*
			- if applicable, the average price or rate (for example strike or forward prices etc.) of the hedging instrument	+*U*
			In situations in which an entity frequently resets (i.e. discontinues and restarts) hedging relationships because both the hedging instrument and the hedged item frequently change and entity does not apply para.23A-B but instead discloses (para 23C):	
			- information about what the ultimate risk management strategy is in relation to those hedging relationships	+*N*
			- a description of how it reflects its risk management strategy by using hedge accounting and designating those particular hedging relationships	+*N*
			- an indication of how frequently	+*N*

IFRS 7 (2010)	ED/2010/13 Hedge accounting	AC [a]	IFRS 7 (effective 2018)	AC [a]
			the hedging relationships are discontinued and restarted as part of the entity's process	
	An entity shall disclose by risk category a description of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term	+*N*	Yes	
	If other sources of hedge ineffectiveness emerge in a hedging relationship, an entity shall disclose those sources by risk category and explain the resulting hedge ineffectiveness	+*N*	Yes	
For cashflow hedges, a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur (para.23(b))	Yes		Yes	
	The effects of hedge accounting on financial position and performance (para.49-52)		**(para.24)**	
	An entity shall disclose, in a tabular format, the following amounts related to items designated as hedging instruments separately by risk category for each type of hedge (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation (para.24A)		Yes	
	- the carrying amount of the hedging instruments (financial assets separately from financial liabilities	+*U*	Yes	
			- the line item in the statement of financial position that includes the hedging instrument	+*U*
			- the change in fair value of the hedging instrument used as the basis for recognising hedge ineffectiveness for the period	+*U*
	- the nominal amounts (including quantities such as tonnes or cubic metres) of the hedging instruments	+*U*	Yes	
	An entity shall disclose, in a tabular format, the following		Yes	

IFRS 7 (2010)	ED/2010/13 Hedge accounting	AC [a]	IFRS 7 (effective 2018)	AC [a]
	amounts related to hedged items separately by risk category for the types of hedges as follows (para.24B):			
	For fair value hedges			
	- the carrying amount of the hedged item recognised in the statement of financial position (presenting assets separately from liabilities)	*+U*	Yes	
			- the accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item recognised in the statement of financial position (presenting assets separately from liabilities)	*+U*
			- the line item in the statement of financial position that includes the hedged item	*+U*
			- the change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period	*+U*
	- the accumulated amount of fair value hedge adjustments remaining in the statement of financial position for any hedged items that have ceased to be adjusted for hedging gains and losses	*+U*	Yes	
	For cash flow hedges and hedges of a net investment in a foreign operation			

IFRS 7 (2010)	**ED/2010/13 Hedge accounting**	**AC [a]**	**IFRS 7 (effective 2018)**	**AC [a]**
- the amount that was removed from equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction (para.23(e))		*-U*		
			- the change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period	*+U*
	- the balances in the cash flow hedge reserve and the foreign currency translation reserve for continuing hedges	*+U*	Yes	
	- the balances remaining in the cash flow hedge reserve and the foreign currency translation reserve from any hedging relationships for which hedge accounting is no longer applied	*+U*	Yes	
	An entity shall disclose, in a tabular format, the following amounts separately by risk category for the types of hedges as follows:		Yes	
For fair value hedges (para.24)	**For fair value hedges**			
- Gains or loss on the hedging instrument (para.24(a)(i))		*-U*		
	- hedge ineffectiveness recognised in profit or OCI	*+U*	Yes	
	- the line item in the statement of comprehensive income that includes the recognised hedge ineffectiveness	*+U*	Yes	
- Gain or loss on the hedged item attributable to the hedged risk (para.24(a)(ii))		*-U*	- change in the FV of the hedged item (para.51(b))	*+U*
For cash flow hedges (para.23)	**For cash flow hedges and hedges of a net investment in a foreign operation**			

IFRS 7 (2010)	ED/2010/13 Hedge accounting	AC [a]	IFRS 7 (effective 2018)	AC [a]
- the amount that was recognised in other comprehensive income during the period (para.23(c))	Yes		Yes	
- the ineffectiveness recognised in profit or loss that arises from cash flow hedges and hedges of a net investment (para.24(b)(c))	Yes		Yes	
	- the line item in the statement of comprehensive income that includes the recognised hedge ineffectiveness	+*U*	Yes	
- the amount that was reclassified from equity to profit or loss for the period, showing the amount included in each line item in the statement of comprehensive income (para.23(d))	- Yes		Yes	
	- the line item in the statement of comprehensive income that includes the reclassification adjustment	+*U*	Yes	
	- for hedges of net positions, the hedging gains or losses recognised in a separate line item in the statement of comprehensive income	+*U*	Yes	
			When the volume of hedging relationships to which the exemption in paragraph 23C applies (for hedging that discontinues and restarts) is unrepresentative of normal volumes during the period (i.e. the volume at the reporting date does not reflect the volumes during the period) an entity shall disclose that fact and the reason it believes the volumes are unrepresentative (para.24D).	+*N*
	An entity shall provide a reconciliation of each component of equity and an analysis of other comprehensive income in accordance with IAS 1 that, taken together:		Yes	
	An entity shall disclose the information required in paragraph			

IFRS 7 (2010)	ED/2010/13 Hedge accounting	AC [a]	IFRS 7 (effective 2018)	AC [a]
	24E separately by risk category. This disaggregation by risk may be provided in the notes to the financial statements			
-	- differentiates, at a minimum, between the different amounts that relate items recognised in OCI for cash flow hedges	+*U*	Yes	
-	- differentiates between the amounts associated with the time value of options that hedge transaction related hedged items and the amounts associated with the time value of options that hedge time-period related hedged items	+*U*	Yes	
			- differentiates between the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge transaction related hedged items, and the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge time-period related hedged items	+*U*
			Option to designate a credit exposure as measured at fair value through profit or loss (para.24G)	
			If an entity designated a financial instrument, or a proportion of it, as measured at fair value through profit or loss because it uses a credit derivative to manage the credit risk of that financial instrument it shall disclose:	
			- for credit derivatives that have been used to manage the credit risk of financial instruments designated as measured at fair	+*U*

IFRS 7 (2010)	ED/2010/13 Hedge accounting	AC [a]	IFRS 7 (effective 2018)	AC [a]
			value through profit or loss in accordance with paragraph 6.7.1 of IFRS 9, a reconciliation of each of the nominal amount and the fair value at the beginning and at the end of the period	
			- the gain or loss recognised in profit or loss on designation of a financial instrument, or a proportion of it, as measured at fair value through profit or loss	*+U*
			- on discontinuation of measuring a financial instrument, or a proportion of it, at fair value through profit or loss, that financial instrument's fair value that has become the new carrying amount in accordance with paragraph 6.7.4(b) of IFRS 9 and the related nominal or principal amount	*+U*

Note. Note. This table shows disclosure requirements deemed relevant for derivative financial instruments only. All versions of IFRS 7 are the IASB's blue book version, which does not include any amendments that are not yet effective. [a] AC = analytical construct. Each disclosure proposed in the exposure draft and subsequently adopted or withdrawn is coded as uniform, complex or commercially sensitive. Narrative disclosures are coded 'N' for information purposes. Objectives or non-operational paragraphs are not included in the analysis.

Appendix G Coding examples

The coding approach was applied consistently for all comment letters. Five examples are provided of coding decisions that required judgement.

Example 1 ED 7

CL17 Syngenta International AG, Basel Switzerland (preparer) Example of letter coded as *disagree* for question 3 in the exposure draft that asked whether respondents agreed the proposed sensitivity analysis of market risk was practicable for all entities.

Respondent claimed to, "not disagree with the proposal to disclose a sensitivity analysis of market risk" however subsequently argues it would often not be useful to users and a qualitative market risk disclosure would be more suitable.

Requests to reduce a proposed disclosure, make it optional or a make a quantitative disclosure qualitative, are coded as disagreement with the reason coded separately to facilitate additional analysis.

Original extract from letter

Q3. *Disclosure of a sensitivity analysis*

We do not disagree with the proposal to disclose a sensitivity analysis for market risk, particularly in light of BC36(a) which states that users have consistently requested this. We would, however, make the following comments:

- Disclosure of "reasonably possible" changes in risk variables is too vague. Not only would comparability across entities be difficult, it could in fact create confusion if different entities consider widely differing changes in risk variables to be "reasonably possible"
- For entities operating in many currencies, multiple geographic and economic environments, sensitivity analysis of market risk could potentially be either be too broad to be meaningful or so detailed that it would impede, rather than increase user's understanding
- In our view, qualitative disclosure about market risk, supported by quantitative information regarding the extent and concentrations of risk as required by para 35 (except as it refers to paras 43 and 44) meet the objective of enabling users to evaluate the nature and extent of market risk

Example 2 ED/2008/10

CL42 International Swaps and Derivatives Association, Inc., London UK (preparer industry body) Example of letter coded as *disagree* for question 3(a) which asked stakeholders whether they agreed with disclosures in section 27B of the exposure draft, for items measured at fair value using Level 3 inputs. This question concerned three substantive new disclosures contained in paragraph 27B: a requirement for a reconciliation of items measured using Level 3 inputs, a requirement to disclose movements between levels in the fair value hierarchy, and a requirement to disclose realised and unrealised gains and losses separately.

Respondent agreed with one disclosure and disagreed with two disclosures (one outright disagreement and one should be qualitative).

Disagreement with one or more substantive disclosures in a question about more than one substantive disclosure was coded as disagreement with the reason coded separately to facilitate additional analysis.

Original extract from letter

Question 3
Do you agree with the proposals in:

a) Paragraph 27B to require expanded disclosures about fair value measurements recognised in the statement of financial position? If not, why? What would you propose instead and why?

As a precursor to our feedback below, we would encourage the IASB to weigh carefully the benefit of the proposed disclosure requirements against potential costs that would be incurred in connection with their implementation and on-going compliance. A balance should be struck between the value of the disclosure to the user of the financial statements and the cost of that disclosure to the business.

ISDA agrees that IFRS 7 disclosures should be expanded to incorporate a detailed reconciliation of Level 3 instruments, as this provides useful information to the investor community. However, as currently drafted, the ED also requires disclosure of unrealised profit or loss on Level 3 instruments. ISDA is not convinced that this disclosure would be sufficiently beneficial to users of accounts to justify the considerable cost of preparation. It is not information which is currently used by management of trading organisations and systems are not set up to provide it. Also, it is often unclear what unrealised profit means: would it include, for instance, foreign exchange revaluation gains, or periodic cash flows received under swap contracts?

ISDA supports the requirement in paragraph 27B(e) relating to the disclosures of the movements between the levels of the proposed hierarchy. However, we understand that the intention of the IASB was that such disclosures should be qualitative in nature yet the wording, as drafted, implies that the disclosure could be quantitative. ISDA therefore recommends that the wording should be amended. Quantitative disclosure of movements between Levels 1 and 2 would be very costly to prepare for many institutions and of limited value to a user of the accounts.

Example 3 ED/2008/10

CL78 the Institute of Chartered Accountants in England and Wales, London UK (accounting industry body) Example of letter coded as *agree* for question 3(a) which asked stakeholders whether they agreed with disclosures in section 27B of the exposure draft, for items measured at fair value using Level 3 inputs (see example 2).

Although raising quite strong cost/benefit concerns, and requesting clarification of what is realised and what is unrealised, this letter agrees with all of the proposals in para 27B. They suggest an additional qualitative disclosure to clarify one matter.

Requests for clarification or application guidance did not indicate disagreement. Requests for additional disclosure did not indicate disagreement.

Original extract from letter

Question 3: Do you agree with the proposals in:

(a) paragraph 27B to require expanded disclosures about the fair value measurements recognised in the statement of financial position? If not, why? What would you propose instead, and why?

15. We agree with the disclosures proposed by 27B (a), (d) and (e).

16. We note that the disclosures proposed by 27B (b) and (c) mirror the disclosures requirements in SFAS 157. Many, if not most, entities do not report such information to key management personnel (because it does not reflect how risk is managed internally) and we can foresee that significant systems changes will be necessary for many preparers to gather the information. Given the investment needed in technology and that the requirements under IFRS and US GAAP are not identical - eg, the deferral of day 1 profit - we question whether these disclosures meet the criteria of a reasonable cost/benefit test. However, we agree with the proposals because we understand the need for investors to have access to information similar to that required under SFAS 157.

17. We also note that the term 'unrealised gains or losses' is used in the standard, although it is not defined. The term is used in different contexts around the world; for example, there is considerable guidance in the UK on realised and unrealised gains which is used in the context of determining distributable profits. This guidance would not be relevant to the disclosure envisaged by the IASB but the use of an undefined term such as 'unrealised' could cause confusion. We assume that the aim of the disclosure requirement is to indicate the extent to which gains and losses have been recognised that do not represent cash inflows or outflows. We also believe that a definition of the term 'unrealised gains or losses' is not desirable, instead we suggest that the final standard includes a qualitative disclosure requirement so that companies explain what they consider to be unrealised for this purpose. An example to demonstrate the complexity of defining unrealised gain and losses is that cash inflows on a swap may be repaid at a later date if market conditions change.

Example 4 ED/2009/3

CL82 Korea Accounting Standards Board (Regulator) Example of letter coded as *disagree* for question 11, which asked stakeholders whether they agreed with the proposed disclosures for derecognised assets.

This respondent says that they agree with the proposed disclosures however believe that they may be excessive for preparers. They then identify a large block of proposed uniform disclosures as an example of what is excessive. Respondent says this information "could" already be provided in existing IFRS 7. Indicates they would prefer disclosure to be less prescriptive.

Requests to reduce a proposed disclosure, make it optional or a make a quantitative disclosure qualitative, are coded as disagreement with the reason coded separately to facilitate additional analysis.

Original extract from letter

Question 11.Disclosures

Do you agree with the proposed amendments to IFRS 7? If not, why? How would you propose to amend those requirements instead, and why?

We agree with the proposed extension of disclosures. However, we believe that some proposed disclosure requirements may result in excessive disclosures from the perspective of preparers.

For example, information required in paragraph 42D(e)-(h) of the exposure draft is not necessary because they could be provided according to the existing requirement in IFRS 7.

Example 5 ED/2010/13

CL40 Grant Thornton (Audit firm) Example of letter coded as *disagree* for question 13(a) which asked whether respondents agreed with the proposed amendments to IFRS 7 for hedge accounting.

This respondent says that they agree with the "objectives" of the disclosures. They believe that large amounts of the proposed new disclosures are overly prescriptive and that entities should have more freedom of what to disclose.

Requests to reduce a proposed disclosure, make it optional or a make a quantitative disclosure qualitative, are coded as disagreement with the reason coded separately to facilitate additional analysis.

Original extract from letter

Question 13

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

(b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?

We support the objectives expressed in the ED relating to the disclosure of an entity's risk management structure and the effects of its hedging activities. We are concerned however that the disclosure requirements proposed in paragraphs 49 to 52 of the ED are overly prescriptive. While the information specified may well be useful, we feel that entities should be given greater freedom in deciding how much detail to disclose.